AN INVESTIGATION OF THE TAX IMPLICATIONS OF A CESSION OF THE RIGHT TO RECEIVE A DIVIDEND

By

Estian Haupt

Thesis presented in partial fulfilment of the requirements for the degree
Master of Accounting (Taxation) in the
Faculty of Economic and Management Sciences
at Stellenbosch University

Supervisor: Mr Rudie Nel

March 2017

DECLARATION

By submitting this thesis electronically, I declare that the entirety of the work contained therein is my own, original work, that I am the sole author thereof (save to the extent explicitly otherwise stated), that reproduction and publication thereof by Stellenbosch University will not infringe any third party rights and that I have not previously in its entirety or in part submitted it for obtaining any qualification.

March 2017

SUMMARY

In South Africa Dividends Tax was introduced with effect from 1 April 2012. The effect hereof was a shift away from a company-level tax to a shareholder-level tax. The introduction of Dividends Tax has, however, complicated the cession of a right to income even further. In order to prevent avoidance schemes that utilised the exemptions from Dividends Tax, in particular the exemption of South African resident companies, the legislature has enacted numerous amendments since 2011 directly dealing with the tax implications of the cession of a right to receive a dividend. There is currently a lack of definitive guidance on the tax implications of a cession of the right to receive a dividend, other than for purposes of Dividends Tax. The purpose of this research was to investigate the tax implications of the cession of a right to receive a dividend with reference to not only Dividends Tax, but also Securities Transfer Tax, Value-Added Tax, Donations Tax and Normal Tax (which includes Capital Gains Tax), and to attempt to formulate guidelines and provide appropriate guidance.

In investigating the tax implications of a cession of a right to receive a dividend, it is necessary to consider the nature of a share and whether the type of right being ceded is a real right or a personal right, as the tax treatment in respect of different rights would differ. Based on the literature review conducted, it was found that the rights created as a result of the cession of the right to receive a dividend would depend on the circumstances of each case and although it is submitted as a personal right in principle, could constitute a real right when the parties intend to create a usufruct. This uncertainty further lends support for the necessity for definitive guidance to enable taxpayers to determine their tax obligations.

The tax implications of the cession of a right to a dividend with regard to Securities Transfer Tax, Value-Added Tax, Donations Tax, Normal Tax (which includes Capital Gains Tax implications) and Dividends Tax was investigated and the findings concluded in a table which could be used in drafting the definitive guidance.

OPSOMMING

In Suid-Afrika is Dividendbelasting sedert 1 April 2012 effektief. Die effek hiervan is ŉ verskuiwing van belasting op ŉ maatskappyvlak na belasting op ŉ aandeelhouersvlak. Die inwerkingtrede van Dividendbelasting het egter die sessie van die reg tot inkomste selfs verder gekompliseer. Die wetgewer het sedert 2011 verskeie wysigings gemaak ten einde vermydingskemas te verhoed wat die vrystelling van Dividendbelasting tot gevolg het – veral dié van Suid-Afrikaanse inwonermaatskappye. Sodanige wysigings handel direk met die belastinggevolge van die sessie van ŉ reg om ŉ dividend te ontvang. Daar is tans ŉ tekort aan beslissende leiding van die belastinggevolge van ŉ sessie van die reg om ŉ dividend te ontvang, behalwe vir doeleindes van Dividendbelasting. Die doel van hierdie navorsing was om die belastinggevolge van die sessie van die reg om ŉ dividend te ontvang te ondersoek vir doeleindes van nie net Dividendbelasting nie, maar ook Belasting op die Oordrag van Sekuriteite, Belasting op Toegevoegde Waarde, Skenkingsbelasting en Normale Belasting (wat Kapitaalwinsbelasting insluit), in ŉ poging om riglyne te formuleer wat leiding verskaf.

Om die belastinggevolge van ŉ sessie van die reg om ŉ dividend te ontvang te bepaal, is dit nodig om die aard van ŉ aandeel te oorweeg en om vas te stel of die reg wat sedeer word ŉ saaklike of ŉ persoonlike reg is, aangesien die belastinggevolge ten opsigte van verskillende regte kan verskil. Gebaseer op die literatuurstudie is daar gevind dat die regte geskep, as gevolg van die sessie van ŉ reg om ŉ dividend te ontvang, sal afhang van die omstandighede van elke geval en al word dit voorgelê dat dit in beginsel ŉ persoonlike reg sal wees, kan dit ŉ saaklike reg wees indien die partye bedoel om ŉ vruggebruik te skep. Die onsekerheid leen verder gewig aan die noodsaaklikheid van beslissende leiding om belastingbetalers in staat te stel om hul belastingverpligtinge te bepaal.

Die belastinggevolge van ŉ sessie van die reg om ŉ dividend te ontvang is ondersoek ten opsigte van Belasting op die Oordrag van Sekuriteite, Belasting op Toegevoegde Waarde, Skenkingsbelasting, Normale Belasting (wat gevolge ten opsigte van Kapitaalwinsbelasting insluit) en Dividendbelasting. Die bevindinge van die studie is saamgevat in ŉ tabel wat van hulp kan wees by die opstel van die beslissende leiding.

TABLE OF CONTENT

LIST OF FIGURES

LIST OF TABLES AND FIGURES

CHAPTER 1

INTRODUCTION

1.1. Background

The cession of a right to income has been part of South African tax law since as early as the 1940s (see *Hiddingh v CIR,* 1940). Morphet (2011:3) commented that the advent of Dividends Tax would further complicate the cession of a right to income and in the absence of the exclusions from the dividends exemptions there would be a withholding of Dividends Tax if the dividend is received by a natural person but not if received by a resident company. Dividends Tax was introduced in South African tax law with effect from 1 April 2012, due to the need to shift from a company-level tax to an internationally applied method of shareholder-level tax (SARS, 2008:24). Exemptions from Dividends Tax are provided in terms of section 64F of the South African Income Tax Act No. 58 of 1962 (South Africa, 1962), (the IT Act), depending on the nature of the beneficial owner.

In addition, on 31 August 2012 the National Treasury released an extraordinary Joint Media Statement with the South African Revenue Service (SARS) in which it was indicated that significant tax avoidance schemes relating to Dividends Tax were identified (National Treasury, 2012). One such a scheme involved foreign shareholders ceding their rights to receive dividends, after the declaration but prior to payment thereof, to a resident company for the amount of the dividend less a fee. The alleged result is that the foreign shareholder receives exempt foreign source income from the disposal of the right, while the South African company thereafter receives taxable income from the cession, which could be off-set against the expenditure incurred in the acquisition of that right. Effectively this reduces the Dividends Tax rate to zero with only the fee earned by the resident company being subject to Normal Tax.

To provide for the taxation of a cession of the right to receive a dividend, and prevent potential abuse, various provisions have been inserted and amended in the IT Act and Securities Transfer Tax Act No. 25 of 2007 (South Africa, 2007), (the STT Act) in terms of the Taxation Laws Amendment Acts (TLAAs) which are summarised in **Table 1.1**.

Table 1.1: Taxation Laws Amendments

Amendment	Explanatory Memorandum
Securities Transfer Tax	
Deletion of paragraph 1(c) of the definition of 'Security' in the STT Act (TLAA No. 24 of 2011)	A right or entitlement to receive any distribution from any company as a result of a cession will no longer be a 'security' for Securities Transfer Tax purposes. Dividend cessions will no longer be subject to Securities Transfer Tax as a cession of dividends will be treated as ordinary income.
Normal Tax	
Section 10(1)(k)(i)(ee) inserted in the IT Act (TLAA No. 24 of 2011)	A ceded dividend to a company no longer has any connection with the underlying share. It merely becomes another income stream and should be fully taxable.
Section 10(1)(k)(i)(ee) repealed and replaced (TLAA No. 22 of 2012)	The dividend exemption will not be available to dividends received by a company as a result of a cession or by the exercise of a discretionary trust.
Section 10(1)(k)(i)(ee) amended (TLAA No. 31 of 2013)	The dividend exemption will apply if the company acquires all the rights associated with the share.
Dividends Tax	
Section 64EB inserted in the IT Act (TLAA No. 22 of 2012)	This is an anti-avoidance provision that deems the cedent to be the beneficial owner of a dividend if the cession took place after announcement or declaration of the dividend but prior to payment.
Substitution of section 64EB of the IT Act (TLAA No. 31 of 2013)	Certain technical anomalies were addressed and grammatical changes effected.

As shown in **Table 1.1** there have been several amendments since 2011 directly dealing with the taxation of a cession of the right to receive a dividend. The implications of a cession of the right to receive a dividend are therefore constantly changing. To assist taxpayers in the interpretation and application of the tax laws, SARS drafts and issues several guides, including the Comprehensive Capital Gains Tax Guide (Issue 5), the Tax Guide for Share Owners (Issue 4) and the Comprehensive Guide to Dividends Tax. The Comprehensive Capital Gains Tax Guide (SARS, 2015a:314) contains only a brief reference to the Capital Gains Tax implication of a cession of a dividend, while the other guides deal exclusively with the Dividends Tax implications of a cession of a right to receive a dividend. No guidance is provided in relation to the effect of a cession of the right to receive a dividend in relation to Normal Tax (including Capital Gains Tax) and its interaction with Dividends Tax, Securities Transfer Tax, Value-Added Tax and Donations Tax. By way of introduction the meaning of 'dividend', 'beneficial owner' and 'cession' and the right which is ceded therefore requires discussion.

Section 64D of the IT Act contains a definition of 'dividend' for purposes of Dividends Tax. This definition refers to the definition of a 'dividend' in section 1 of the IT Act which determines that a dividend will be any amount that is transferred or applied by a company, that is a resident, for the benefit or on behalf of any person in respect of any share in that company. A 'share' is defined in the IT Act as any unit into which the proprietary interest in a company is divided. The meaning of a 'share' has also been considered in our courts. Corbett JA in *Standard Bank of South Africa Ltd and Another v Ocean Commodities Inc and Others* (1983:151) described a share in a company as a bundle or conglomerate of personal rights that entitles the holder thereof to an interest in the company, its assets and dividends. The 'beneficial owner' of a share, for purposes of Dividends Tax, is defined as the person who is entitled to the benefit of the dividend attaching to a share (section 64D of the IT Act). Applying the definition of a beneficial owner to the definition of a share in *Standard Bank of South Africa Ltd and Another v Ocean Commodities Inc and Others* (1983), the beneficial owner will be the person who has a personal right entitling that person to an interest in the dividends of the company.

A ‘cession’ is not defined in the IT Act and must therefore be given its grammatical and ordinary meaning which was determined by the court in *Lynn & Main Inc v Brits Community Sandworks CC* (2008) to mean a method by which incorporeal rights are transferred between a transferor (the cedent) and a transferee (the cessionary) by means of mere agreement. This could lead to a dividend being ceded, by mere agreement between two parties, from a taxable entity to an exempt entity, without the disposal of all the interests attaching to the share, such as voting rights and a right to the assets of the company. Such cession could however result in certain tax avoidance schemes, for example where an individual cedes its right to receive a dividend to a resident company, with the effect that the dividend becomes exempt from Normal and Dividends Tax when received by the company.

It has been submitted that an existing right, even when subject to conditions, can be ceded, while the cession of a *spes* or hope is more controversial (Van der Merwe, 1998:355). The controversy stems from the fact that a future right is a non-existent right which cannot be transferred under common law (Van der Merwe, 1998:366). It was, however, accepted in *ITC 1378* (1983:233) that a right to receive a dividend (declared or not declared) can be ceded. In this case (at 234) the court held that the right to receive a dividend is an existing right, which can accordingly be ceded, and not a future right or a mere *spes*. In the alternative the court supported the view expressed in *Schreuder v Steenkamp* (1962), that even if the right to receive a dividend was a future right, or a *spes*, it could in any event be validly ceded. The view that a cession of a conditional right as well as a mere *spes* can be validly ceded was upheld by the Supreme Court of Appeal in *Lynn & Main Inc v Brits Community Sandworks CC* (2008) (Van der Merwe, 1998:362). It follows that the beneficial ownership of a dividend (declared or not declared) can be validly ceded, apart from the rights to an interest in the company (i.e. voting rights) or its assets, which forms part of the conglomerate rights that constitute a share. It is therefore not disputed that a dividend can legally be ceded, but it is submitted that the classification of the nature of the right ceded (as personal or real right) should also be investigated as the tax implications based on this classification will differ.

It was held in *Cooper v Boyes NO and Another* (1994:488(2)) that a share can be subject to a usufruct and it has subsequently been argued that a share could also be subject to a quasi-usufruct (Leos, 2006:126-146). De Koker and Williams (2016c:23.6) state that a usufructuary interest is a real right which entails the enjoyment of the income from the property of another, which could consist of the dividends on shares. It follows that the right to receive a dividend, where that right constitutes a usufruct, is a real right and what the cedent cedes is therefore a real right. This must, however, be contrasted with the judgement in *Standard Bank of South Africa Ltd and Another v Ocean Commodities Inc and Others* (1983:151) that describes shares as a complex bundle of personal rights. De Koker and Williams (2016c:23.6) similarly state that a contractual right to receive the net income of shares will not be a 'like right' to a usufruct of shares as it is a personal right. It is therefore submitted that it is uncertain whether the right to receive a dividend constitutes a real right (where there is a usufruct over the shares) or a personal right (which could merely entitle the owner to claim payment of a dividend if declared). This matter merited further investigation.

1.2. Research problem

Due to the uncertainties and points for investigation alluded to, the tax implications of a cession of the right to receive a dividend needs to be investigated to provide guidance for the cedent, cessionary and declaring company involved in the cession. The uncertainty in this regard has been created by the numerous amendments and a lack of definitive guidance from SARS.

In order to provide guidance on the tax implications of a cession of the right to receive a dividend, the following legislation was investigated in the study:

- the Securities Transfer Tax Act;
- the Value-Added Tax Act (the VAT Act);
- Donations Tax in terms of the Income Tax Act;
- Normal Tax (including Capital Gains Tax) in terms of the Income Tax Act; and
- Dividends Tax in terms of the Income Tax Act.

Taxpayers who enter into agreements whereby rights to receive a dividend are ceded currently do not have any guidance on the tax implication of such a transaction, other than the implications for Dividends Tax purposes.

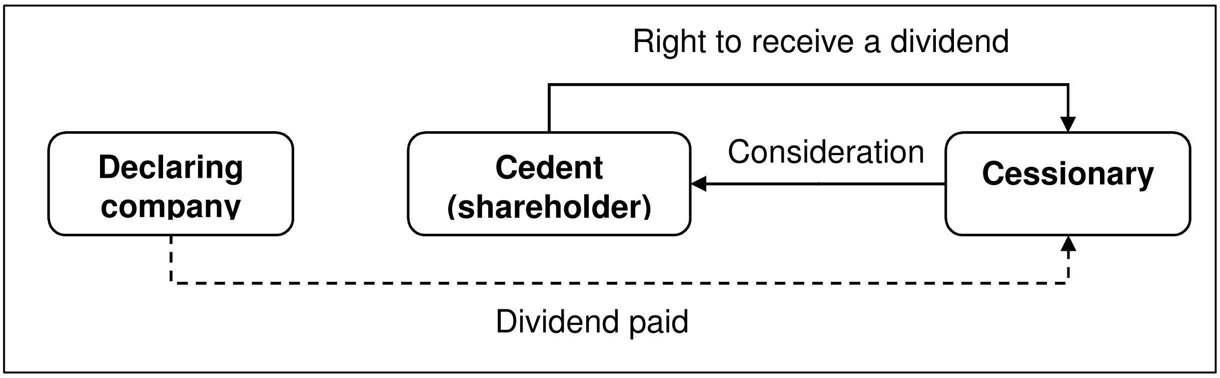
1.3. Research objective and rationale for this research

The objective of this research was to investigate the tax implications of a cession of the right to receive a dividend for the cedent, cessionary and declaring company involved in the cession. Such an investigation necessitated the consideration of the tax implications for:

- the person who was the beneficial owner of the dividend, who subsequently cedes such right (the cedent);
- the person who receives the right to receive the dividend as a result of the cession and becomes the beneficial owner (the cessionary). The cessionary would, in a rational transaction, have to pay consideration in exchange for the right received from the cedent; and
- the declaring company in which the abovementioned shares are held.

For ease of reference the basic structure of a cession of the right to receive a dividend is illustrated in **Figure 1.1** below.

Figure 1.1: Basic structure of a cession of the right to receive a dividend



In the process of investigating the abovementioned implications, the interaction between the various tax types and the tax liabilities resulting from a single cession were investigated and formulated. Through this research a summary could be provided of the overall tax implications of a cession of the right to receive a dividend for the cedent, cessionary and declaring company involved in the cession. Clarity on the tax implications could serve as a basis for tax planning procedures for shareholders and companies wishing to acquire a stream of dividend income. This research could further assist SARS and the legislature in enacting amendments or providing clarity where uncertainties remain.

1.4. Research design and methodology

In this research, the historical method of research was chosen as research methodology. A literature review was performed with the purpose of determining the tax implications for the cedent, cessionary and declaring company involved in a cession of the right to receive a dividend.

Sources used include statutory laws, case law, interpretations and guides from SARS, academic articles, dissertations, academic books and non-academic articles and magazines of reputable law and audit firms.

The investigation relied mostly on the SUNSearch databases in the identification of literature. The following key words and combinations thereof were used in searching for relevant literature: ‘tax’, ‘VAT’, ‘CGT’, ‘right’, ‘entitlement’, ‘cession’, ‘ceding’, ‘surrender’, ‘dividend’, ‘distribution’ and ‘future dividend’. Searches were mainly performed on SA e-Publications, LexisNexis Law Databases (South Africa), Jutastat – Law databases, National ETD, Google Scholar and the SARS website.

1.5. Scope

This research was limited to an investigation of the South African tax implications of a cession of the right to receive a dividend.

1.6. Organisation of the research

Chapter 2 covers an investigation into the nature of the rights which constitute a share and the right to receive a dividend. This investigation included a determination of whether these rights constitute personal rights or real rights. In this investigation it was also considered whether the cession of the right to receive a dividend constitutes the cession of a right to future income. When investigating the tax implications of the cession of the right to receive a dividend, it must be determined whether the right which is being ceded is a personal right or a real right as a real right could indicate that a usufruct exists. In such a case consideration must be given to the specific provisions of the IT Act which provides for the taxation of usufructs, such as paragraphs 31(1)(d) and 31(2) of the Eighth Schedule to the IT Act ('the Schedule') which provides the manner in which the market value of such an asset must be determined for purposes of Capital Gains Tax. Should it be found that the right to receive a dividend is ceded as a personal right, it must be considered whether the personal right constitutes an asset for purposes of the Schedule, as it has been accepted and confirmed in the Comprehensive Guide to Capital Gains Tax (SARS, 2015a:45) that the personal right to claim payment would not in all cases be regarded as an asset for purposes of Capital Gains Tax. It is therefore submitted that the nature of the right to receive a dividend (as a real right or a personal right) must first be investigated before the tax implication of the cession of that right can be determined.

Chapter 3 explores the Securities Transfer Tax implications. The effect of the removal of paragraph 1(c) of the definition of 'Security' in the STT Act is considered.

Chapter 4 investigates the possibility of Value-Added Tax (VAT) being levied. The chapter includes a determination of whether a cession of the right to receive a dividend is the supply of goods or services and consequently if such a cession gives rise to VAT implications.

Chapter 5 discusses the possibility of Donations Tax being levied. It includes a determination of the circumstances where a cession of the right to receive a dividend could be regarded as a donation.

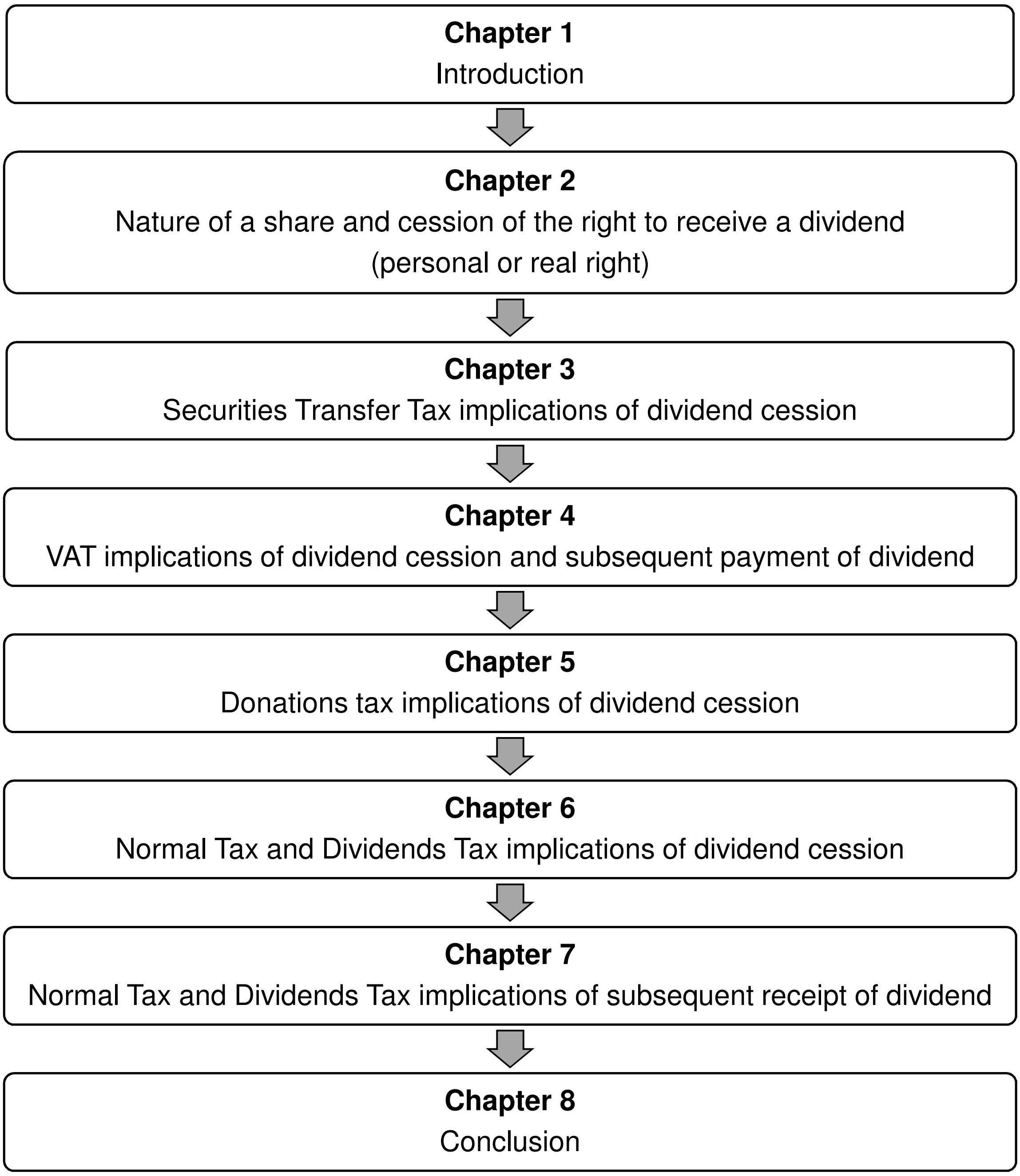
Chapter 6 considers the Normal Tax implications, which include Capital Gains Tax, in respect of the cession of the right to receive a dividend. The interaction between Income Tax and Securities Transfer Tax is also considered.

In Chapter 7 the Normal Tax implications, which include Capital Gains Tax, in respect of the subsequent receipt of the dividend (after the initial cession) is investigated. The focus is drawn to the anti-avoidance provisions relating specifically to cessions and the tax implications thereof. The interaction between Dividends Tax and Normal Tax is considered in this chapter, specifically with regard to possible double taxation.

In Chapter 8, the concluding chapter, a summary of this research is provided. This chapter primarily consists of a table providing the tax implications of a cession of the right to receive a dividend, illustrating the tax type and implication for the cedent, cessionary and declaring company involved in the cession.

Figure 1.2 below provides a summary of the structure and flow of the research as presented in this thesis.

Figure 1.2: Structure and flow of research



CHAPTER 2

NATURE OF A SHARE AND THE RIGHT TO RECEIVE A DIVIDEND

2.1. Background

A share in a company is an example of an incorporeal object which cannot be seen, heard, touched smelled or tasted, as stated in the Comprehensive Guide to Capital Gains Tax (SARS, 2015a:42). The tax implications of the cession of the right to receive a dividend, which forms part of the bundle of rights that constitutes a share, can differ depending on the nature thereof as a real or personal right. A distinction must therefore be drawn between real rights and personal rights. Such a distinction is also important to determine whether the law of property or the law of things is to be applied. Furthermore, the distinction determines the remedy available to a person, as owner of the right, if such right is violated or encroached upon (Badenhorst, Pienaar & Mostert, 2015:4.3). Several theories have been developed to assist in distinguishing between real rights and personal rights, as discussed in Silberberg and Schoeman's *The Law of Property* (Badenhorst et al., 2015:4.3). The most important of the theories are the classical theory and personalist theory (Van der Walt & Maass, 2012:39).

The classical theory has regard to the relationship to which the right relates. The relationship can be between a person and an object or between persons (Badenhorst et al., 2015:4.3). A right between a person and an object would grant the owner thereof with the full rights of control of that object (Van der Walt & Maass, 2012:40), while a right between persons would have performance as the object which would grant a person with a right to oblige another person to perform, or not perform, in a certain manner (Van der Merwe, 2015:60).

In terms of the personalist theory a distinction is made between a real right and a personal right by having regard to the persons against whom those rights are enforceable (Badenhorst et al., 2015:4.3.2). This theory is concerned with whether the right is enforceable against all persons or whether the right is enforceable only against a particular person or group of persons who are party to the particular obligation (Van der Merwe, 2015:40, 60).

When confronted with the question as to whether a right is a real right or a personal right, the South African courts have also had regard to the subtraction from the *dominium* test (Badenhorst et al., 2015:4.4; *Ex Parte Geldenhuys* (1926:164)). The subtraction from the *dominium* test concerns itself with whether the right diminishes the ownership of the owner of the object by restricting the owner from exercising all the rights of ownership (Van der Walt & Maass, 2012:40). The difference between a real right and a personal right in terms of the subtraction from the *dominium* test is, however, only a question of degree of the limitation imposed on an owner's right of ownership, as both real rights and personal rights may place restrictions on an owner's right of ownership, but a personal right has the performance of the owner as object, while a limited real right attaches to the property and has the property as object (Badenhorst et al., 2015:4.3.6).

Another test considered by the South African courts in this regard is the intention test which focuses on whether the parties intended the particular right to be binding on any successors in title (Van der Walt & Maass, 2012:44; *Cape Explosive Works Ltd and Another v Denel (Pty) Ltd and others* (2001:21)).

In concluding, the theories and principles for distinguishing between a real right and a personal right are summarised in **Table 2.1** below.

Table 2.1: Theories considered in distinguishing between rights

Theory	Principle of theory
Classical theory	This theory is concerned with whether the right constitutes a relationship between a person and an object or between persons.
Personalist theory	This theory has regard to against whom the right is enforceable.
Subtraction from the *dominium* test	It must be determined whether the right places a burden on the owner's right of ownership of an object or on the owner as person.
Intention test	The intention of the parties to bind successors in title of the object is considered herein.

Source: Author's compilation

To determine whether a real right or a personal right exists the principles set out in **Table 2.1** are discussed below.

2.2. Distinguishing between real rights and personal rights

Applying the principle of a classical theory as summarised in **Table 2.1** above, a real right is concerned with the relationship between a person and an object, which provides the owner thereof with absolute right and control over that object, while a personal right is concerned with the relationship between two persons, where the owner of the right merely has a right to enforce performance by another person (Badenhorst et al., 2015:4.3.1). The Comprehensive Guide to Capital Gains Tax similarly states that a real right is a right in an object (SARS, 2015a:44), while a personal right is a right between persons, for example between the parties to a contract, which can be a right to claim delivery of an object or performance of an act (SARS, 2015a:43). Further to real rights, the category of limited real rights has been recognised, which right is concerned with the relationship of a person and the object of another which confers on the owner of the right a right over the property of another (Johnson, 2016:75).

In terms of the principle of the personalist theory a real right is enforceable against all other persons, in other words a real right can be enforced against any person who deals with the object to which that right relates in a manner which violates or encroaches on that right (Badenhorst et al., 2015:4.3.2). A real right can therefore be described as an absolute right (Van der Walt & Maass, 2012:39). A personal right, however, is a right which is enforceable only against a particular person or group of persons on the basis of a legal relationship between them, for example the parties to a contract, and personal rights can therefore be described as relative rights (Badenhorst et al., 2015:4.3.2). In terms of the Comprehensive Guide to Capital Gains Tax an example of a real right is where a seller transfers an object to a buyer; once the transfer occurs the new owner will have the exclusive, or absolute, right of enjoyment of that asset (SARS, 2015a:44). In other words, should any other person encroach on that right the new owner will be able to enforce its rights of exclusive enjoyment against such person. A personal right, however, is a right between persons, for example between the parties to a contract, which can be a right to claim delivery of an object or performance of an act only from that specific person or persons (SARS, 2015:43).

In terms of the subtraction from the *dominium* test a personal right places the burden of performance on the owner of an object in his personal capacity and not against that object, while a real right places a burden on the owner's right of ownership of an object itself (Badenhorst et al., 2015:4.3.6). It has been noted that not all restrictions on the ownership of a person would constitute a real right. The subtraction from *dominium* test therefore provides that a limited real right could exist where the right burdens or diminishes the owner's rights by preventing the owner from exercising its rights to ownership to such an extent that it can be said that part of the ownership of the object has been transferred to the other person (Van der Walt & Maass, 2012:39).

With regard to the intention test, an intention to bind successors in title of the object (that is to say not only the present owner but also the subsequent owner) indicates a real right, while no intention to bind successors in title indicates a personal right (Badenhorst et al., 2015:4.3.6–4.3.7).

In concluding, the theories and tests to distinguish between real rights and personal rights are summarised in **Table 2.2** below for ease of reference in discussions to follow.

Table 2.2: Principles of theories for real rights and personal rights

Theory	Real rights	Personal rights
Classical theory	The relationship is between a person and an object.	The relationship is between persons.
Personalist theory	The right is an absolute right and is enforceable against all persons.	The right is a relative right and is enforceable only against a specific person or group of persons.
Subtraction from the *dominium* test	The burden is on an owner's ownership of an object to such an extent that a part of the ownership has been transferred.	The right burdens the owner in his personal capacity.
Intention test	The intention of the parties is to bind successors in title.	The intention of the parties is not to bind successors in title.

Source: Author's compilation

To determine whether a real or personal right exists, it is therefore important that the object over which that right exists be identified and the relationship between the parties be established. Based on the summary provided in **Table 2.2**, the rights attached to a share and the right to receive a dividend is subsequently discussed, based on the literature considered. Where a dividend is ceded it is submitted that there are two different rights which are relevant and should be considered:

- Firstly, the rights attached to a share (ignoring any cession of the right to receive a dividend). In other words, the nature of the bundle of rights, constituting a share, which confers rights between the shareholder and the company.
- Secondly, the rights created as a result of the cession of the right to receive a dividend. This is the right which comes into existence between the shareholder (as cedent) and the cessionary as a result of the cession.

2.3. Rights attached to a share

The relationship between a shareholder and a company is regulated by the Companies Act No. 71 of 2008 (South Africa, 2008), (the Companies Act). Section 1 of the Companies Act defines a shareholder as the holder of a share who is entered as such in the securities register of that company. Section 37(9) of the Companies Act further provides that a person acquires the rights associated with any particular securities when that person's name is entered in the company's certificated securities register or as determined by the rules of the central securities depository. In other words, a person does not acquire any rights in respect of shares in a company against that company unless that person is also the shareholder. The effect of the Companies Act is that the company needs only to be concerned with the registered shareholder and not any other person (*Standard Bank of South Africa Ltd and Another v Ocean Commodities Inc and Others* (1983:289)). Stated differently, only the registered shareholder (who might be acting as a nominee of the beneficial owner) can enforce the rights attaching to the shares (Joubert, 2012:193).

A share, as a complex bundle of rights, entitles the registered shareholder to receive notices, to vote in respect of these shares, and to receive dividends and/or a return of capital (Joubert, 2012:193). Where a person acts as a nominee he would likely bind himself to act on behalf of the beneficial owner in a manner consistent with the agreement between himself and the beneficial owner (Joubert, 2012:193).

It follows that the shareholder holds the direct ownership of the share, in other words the relationship is between a shareholder and an incorporeal object, which can be enforced against all other persons. Based on the tests and theories submitted in **Table 2.2**, the right that a shareholder has against a company, which constitutes a share, could be regarded as a real right over an incorporeal object. The right which exists between a cedent (the shareholder) and the cessionary as a result of a cession must also be considered.

2.4. Rights created as result of cession of a dividend

The Companies Act makes provision for a situation where a person, other than the shareholder, could hold a beneficial interest in a share. A beneficial interest is defined in section 1 of the Companies Act and includes a person who has a right or entitlement to receive or participate in any distribution. The Companies Act will form the basis of the relationship between the shareholder and the beneficial interest holder to some extent. For instance, section 56(3) and section 56(7) of the Companies Act provides the circumstances under which a person has an obligation to disclose information regarding the beneficial interest holder of securities in a public company. Section 56(9) to section 56(11) of the Companies Act further provides the rights and obligations of the shareholder and the beneficial interest holder with regard to meetings of the company. The exact terms of the relationship between the parties would however further be determined by way of agreement between the parties. Based on each of the theories and tests, summarised in **Table 2.2**, the classification of a cession of dividend as a real right or a personal right is explored below.

The classical theory is concerned with whether the right constitutes a relationship between a person and an object or between persons. The object of the right to receive a dividend is the performance of the cedent, which will be regulated in terms of an agreement between the cedent and cessionary. Accordingly it is submitted that, as a result of section 37(9) of the Companies Act, the right to receive a dividend would constitute a personal right as the right would be based on the relationship between the cedent (the shareholder) and the cessionary (the beneficial interest holder) without any direct legal connection with the share.

The personalist theory has regard to the enforceability of a right. The Companies Act provides that a company need only be concerned with the shareholder (that is to say the person registered on the securities register) and not the beneficial interest holder (*Standard Bank of South Africa Ltd and Another v Ocean Commodities Inc and Others* (1983:289)). The beneficial interest holder would therefore not be able to enforce the rights that it has against the company by obligating that company to act or refrain to act in a certain way. The beneficial interest holder will only be able to obligate the shareholder to act, or not act, in a certain manner. For example, where the agreement between the parties provides that any dividend received by the cedent as a result of its shareholding must be paid to the cessionary, the cessionary would be able to demand payment from the cedent. In terms of the personalist theory where a cessionary has the right to oblige the cedent to perform in a certain manner, but has no right against any other person, the right will be regarded as a personal right.

In terms of the subtraction from the *dominium* test, a right is regarded as a real right if it constitutes a burden upon the owner's ownership of an object. In the current circumstances it is contemplated that the right of the cessionary would diminish the cedent's ownership over the shares by limiting the ownership in that the cedent will not have a right to the enjoyment of any dividends. The outcome of the subtraction from the *dominium* test therefore indicates that the right to receive a dividend would constitute a real right.

With the application of the intention test, it must be considered whether the intention with the right to receive a dividend is to bind a successor in title of the share. The intention of the parties would depend on the wording of the agreement between the cessionary and the cedent. The outcome of this test would therefore be dependent on the facts and circumstances of each case and it is contemplated that the intention with regard to a right to receive a dividend could be either to bind, or not to bind, successors in title of the shares.

Based on the aforementioned theories and tests the classification of a cession of dividend is submitted in **Table 2.3** which follows.

Table 2.3: Classification as a real right or a personal right

Theory	Classification of cession of dividend
Classical theory	Personal right
Personalist theory	Personal right
Subtraction from the *dominium* test	Real right
Intentions test	Dependent on wording of agreement

Source: Author's compilation

Accordingly the right between the shareholder and the company will constitute a real right, while the right between the cessionary and the cedent would depend on the circumstances of each case. This conclusion is especially relevant when it has to be determined whether the rights created as result of a cession of the right to receive a dividend could constitute a usufruct. A usufruct can be defined as a right which confers on the usufructuary the right to the use and enjoyment of an object, owned by another person, in a manner which preserves its substance (*Cooper v Boyes NO and Another* (1994:477)).

The question whether a share can be subject to a quasi-usufruct was considered by the court in *Cooper v Boyes NO and Another* (1994), where Van Zyl J performed a detailed analysis of the history of usufructs and quasi-usufructs and their application in South Africa. From the judgement it is evident that a quasi-usufruct is regarded as a usufruct over assets which are consumed as soon as they are used, in which case a true usufruct cannot be applicable as the substantial character of the property cannot be retained (*Cooper v Boyes NO and Another* (1994:483). With regard to shares, the court held that a quasi-usufruct was not possible but that there was no reason why a share cannot be bequeathed subject to a usufruct, where the usufructuary will have the right to receive dividends or other benefits (*Cooper v Boyes NO and Another* (1994:488(2)). The decision has been criticised and it has been argued that a share, for example a preference share, could be subject to a quasi-usufruct having regard to the rights and privileges attaching to that share (Leos, 2006:126–146). It follows that a share can be subject to a usufruct or possibly a quasi-usufruct. It has been held that a usufruct over shares can, where it is created in terms of a will, be created expressly or by implication. Where a usufruct is created by implication it must, however, be by necessary implication (De Waal, Erasmus, Gauntlett & Wiechers, 2011:380). Dealing with the meaning of the term 'necessary implication' as it relates to wills, in *Ex Parte*

Estate Paley (1943:186), Sutton J stated that a necessary implication means not a natural necessity, but so strong a probability of intention that an intention contrary to that which is imputed to the testator cannot be supposed. When determining whether the cession of a right to receive a dividend resulted in a usufruct, the intention of the parties must therefore be clear. In the absence of such a clear intention, it is submitted that the cession of a right to receive a dividend would result in a personal right.

It follows, however, that a share can be subject to a usufruct where it constitutes a limited real right over the share. Whether a share is subject to a usufruct (created by way of the cession of the right to receive a dividend) is therefore dependent on whether the right to receive a dividend constitutes a limited real right over the share. Applying the principles set out in **Table 2.2**, the cession of the right to receive a dividend can constitute either a personal right or a real right, depending on the circumstances of each case. It follows that, depending on the circumstances, the cession of the right to receive a dividend could constitute a usufruct over the share. Accordingly, the tax implications of both scenarios are considered where relevant.

CHAPTER 3

SECURITIES TRANSFER TAX

3.1. Background

The STT Act which was introduced in 2007 replaced the Stamp Duties Act No. 77 of 1968 and the Uncertificated Securities Act No. 31 of 1988. The stated purpose with the introduction of the STT Act was to provide consistent rules for the levying of a single tax, to be known as the Securities Transfer Tax (STT), in respect of any transfer of a listed or unlisted security (SARS, 2007:2).

In terms of section 2 of the STT Act, STT is levied on the transfer of any security, issued by a close corporation or company incorporated in the Republic of South Africa, at a rate of 0.25% of the taxable amount. An amendment of section 1 of the STT Act, effective from 1 April 2012, is submitted to be of key importance in respect of the treatment of a cession of the right to receive a dividend for the purpose of STT. The implications of a cession of the right to receive a dividend prior to and after 1 April 2012 is subsequently discussed as illustration.

3.2. Securities Transfer Tax implications of the cession of the right to receive a dividend prior to 1 April 2012

As determined by section 2 of the STT Act, for STT to be levied there must firstly be a transfer of a security. Prior to 1 April 2012, section 1 of the STT Act defined a ‘security’ to mean any share or depository receipt in a company, any member’s interest in a close corporation or any right or entitlement to receive any distribution from a company or close corporation. The Explanatory Memorandum on the Securities Transfer Tax Bill (SARS, 2007:5) expressly states that the cession of dividend rights would fall within the ambit of the STT Act.

A further requirement of section 2 of the STT Act is that there must be a ‘transfer’ of that security. Section 1 of the STT Act broadly defines a transfer as including the transfer, sale, assignment or cession or disposal in any manner, or the cancellation or redemption of a security. Specifically excluded from the definition is any transfer which does not result in the change of beneficial ownership, the issue of any security, or the cancellation or redemption of a security of a company which is being terminated. It follows that the cession of the right to receive a dividend will constitute a transfer if it results in the change of beneficial ownership.

Where a change in beneficial ownership does not occur, no transfer takes place. The term 'beneficial ownership' is not defined in the STT Act and the plain meaning of the words must be considered to interpret the intention thereof (Clegg & Stretch, 2015). As mentioned above, a share can be described as a conglomerate of personal rights, which entitles the holder thereof to an interest in the company, its assets and dividends (*Standard Bank of South Africa Ltd and Another v Ocean Commodities Inc and Others* (1983)). In relation to laws, 'beneficial' means the right to the use or benefit of property, other than a legal title (Oxforddictionaries.com, n.d.) and 'ownership' means the right of possessing something (Oxforddictionaries.com, n.d.). Read together the beneficial owner would be the person who has the right of possession of the use or benefit of property.

'Beneficial ownership' has also been considered in relation to shares in *Standard Bank of South Africa Ltd and Another v Ocean Commodities Inc and Others* (1983:289). Corbett JA stated that the term 'beneficial ownership' is not juristically speaking wholly accurate, but that it is a convenient term to denote the person in whom the benefit of the bundle of rights constituting a share vests. Corbett JA described the registered shareholder, holding the shares as nominee on behalf of another person, as the owner thereof, while the other person is the beneficial owner. From a statutory point of view certain Acts also define the concept of beneficial ownership. The Companies Act No. 71 of 2008, which succeeded the Companies Act No. 61 of 1973, contains a definition of beneficial interest. In terms of section 1 of the Companies Act No. 71 of 2008, a 'beneficial interest' is defined as the right or entitlement of a person to receive or participate in any distribution in respect of that company's securities. In relation to Dividends Tax, section 64E of the IT Act defines the beneficial owner as the person entitled to the benefit of the dividend attaching to a share.

The Explanatory Memorandum on the Securities Transfer Tax Bill (SARS, 2007:6) states that a transfer for STT purposes relates to the concept of a change in economic ownership, as opposed to a change in mere registration of a security in a share register. However, the Explanatory Memorandum (SARS, 2007) does not provide clarification for the omission of a definition of beneficial ownership from the STT Act, which creates uncertainty. An in-depth analysis of the concept of beneficial ownership for purposes of the STT Act, however, falls outside the scope of this research. For purposes of this research it was assumed that, based on the above, the beneficial owner under the STT Act will be the person who has the right or is entitled to receive any dividend from a company.

It follows that, prior to 1 April 2012, a cession of the right to receive a dividend would have constituted a transfer of a security, resulting in a change of beneficial ownership. Subject to the exemptions contained in the STT Act, a STT liability would have arisen at a rate of 0.25% (section 2 of the STT Act). The person who is liable to pay STT depends on whether the security that is being transferred is a listed or unlisted security. In the case of the transfer of a listed security, through a member or participant, that member or participant will be liable to pay STT (sections 3 and 4 of the STT Act). In any other case of the transfer of a listed security, the person to whom the listed security is transferred is liable for the STT (section 5 of the STT Act). Where an unlisted security is transferred, the company that issued those securities will be the liable party (section 6 of the STT Act). Section 7(2) of the STT Act, however, determines that the participant, member, or company that was liable to pay the STT may recover such amount from the person to whom that security is transferred. The result is therefore that the person who receives the transfer (in the case of a cession, the cessionary) will eventually be accountable to either pay or refund the STT.

3.3. Securities Transfer Tax implications of the cession of the right to receive a dividend on or after 1 April 2012

With effect from 1 April 2012 the definition of ‘security’ in the STT Act has been amended to remove the inclusion of any right or entitlement to receive any distribution from a company or close corporation (South Africa, 2011b). A cession of the right to receive a dividend will accordingly no longer be a security for STT purposes.

The Explanatory Memorandum on the TLAA (SARS, 2011:172) states that a cession of a dividend would no longer be subject to STT, as a receipt of a dividend acquired by way of a cession is viewed as an income stream which is totally independent of the underlying share and as such will be treated as ordinary revenue.

This amendment coincides with the amendment of proviso (ee) to section 10(1)(k) of the IT Act which contains the exemptions of a dividend from Normal Tax (South Africa, 2011b). The Explanatory Memorandum on the TLAA (SARS, 2011:60) states that the receipt of a dividend by a company will no longer be exempt from Normal Tax if the receipt is due to a cession of the right to that dividend without that company acquiring all the rights to that share. The interaction between the Normal Tax implications of a cession of the right to receive a dividend and the STT implications, where the cessionary is a resident company, is examined in **Chapters 6 and 7**.

After 1 April 2012 the cession of the right to receive a dividend will therefore not be subject to STT. The findings related to the STT implications of a cession of the right to receive a dividend are submitted in **Table 3.1** below.

Table 3.1: Summary of Securities Transfer Tax implications of a cession of the right to receive a dividend

Person	Cession *prior to* 1 April 2012	Cession *after* 1 April 2012
Position	The cession of the right to receive a dividend constituted a transfer of a security, resulting in a change of beneficial ownership. Subject to the exemptions contained in the STT Act, an STT liability would therefore have arisen.	The amended definition of security no longer includes any right or entitlement to receive any distribution from a company or close corporation and the cession of the right to receive a dividend would therefore not be subject to STT.
Person liable	The person liable for STT will be, in the case of a security that is: • listed and transferred by a member or participant, that member or participant; • listed and transferred other than by a member or participant, the person to whom the listed security is transferred; and • unlisted, the company who issued the securities that is transferred. Irrespective of the above, the amount paid may be recovered from the person to whom the security is transferred (in other words the cessionary). The cessionary will therefore eventually be accountable to either pay or refund the STT.	None

Source: Author's compilation

CHAPTER 4

VALUE-ADDED TAX

4.1. Background

Value-Added Tax is an indirect tax levied on the consumption of goods and services in the South African economy. The VAT Act provides, subject to the exemptions, exceptions, deductions and adjustments contained in the VAT Act, for the levying of output tax on the supply by a vendor of any goods or services supplied by him in the course or furtherance of an enterprise (section 7(1) of the VAT Act, read with the definition of 'output tax' in section 1 of the VAT Act). In terms of section 7 of the VAT Act, a supply will be subject to output tax at the standard rate of 14%, except as otherwise determined by the VAT Act. Sections 11 and 12 of the VAT Act contain the instances where supplies, which would have been subject to the standard rate but for these sections, are not subject to the standard rate but are rather exempt or subject to a rate of 0%.

The first requirement for section 7 of the VAT Act to apply is that there must be a supply. Section 1 of the VAT Act contains a wide definition of 'supply'. This definition is so wide that it has been held to mean any provision of goods or services in the course of a business (Silver & Beneke, 2015:3.3). Specifically included in the definition of 'supply' is performance in terms of a sale agreement.

Section 7 of the VAT Act further requires that the supply be made by a vendor. A 'vendor' is defined in section 1 of the VAT Act as any person who is, or is required to be, registered as a vendor in terms of the VAT Act. Part III of the VAT Act contains the provisions relating to the registration of a vendor. In terms hereof any person whose total value of taxable supplies, or foreseen taxable supplies, during a 12-month period exceeds or will exceed R1 million, must register as a vendor. A person can also voluntarily register as a vendor if the total value of taxable supplies made by him will exceed R50 000 in a 12-month period. For purposes of this research it was assumed that the cedent meets the relevant requirement and is a registered vendor. Should the cedent not be a vendor, he will not be subject to the provisions of the VAT Act.

A further requirement of section 7 of the VAT Act is that it is necessary for the supply, by the vendor, of goods or services to be made in the course or furtherance of an enterprise. Section 1 of the VAT Act defines an 'enterprise' to mean any activity which is carried on continuously or regularly in South Africa and in the course of which goods or services are supplied for a consideration. The concept of 'continuous and regular' supplies is not defined in the VAT Act and should therefore be interpreted with reference to its ordinary meaning. The Oxford Dictionaries (Oxforddictionaries.com, n.d.) define 'continuous' as 'unbroken whole'; 'without interruption', while 'regular' is defined as 'recurring at uniform intervals', or 'happen[ing] frequently or often'. The Deloitte VAT Handbook describes the concept of a continuous and regular activity as an ongoing activity, which excludes once-off, private supplies (Silver & Beneke, 2015:3.7).

A further requirement of both the definition of 'enterprise' and section 7 of the VAT Act is that 'goods or services' must be supplied. 'Goods' is defined by section 1 of the VAT Act as any corporeal movable thing, fixed property or any real right in any such thing. 'Services' is widely defined in section 1 of the VAT Act and would include almost any type of activity that does not qualify as the supply of goods (Silver & Beneke, 2015:3.6). Of particular interest to this research is that the definition of 'services' in section 1 of the VAT Act specifically includes the granting, assignment or cession of any right. Lastly the definition of 'enterprise' in section 1 of the VAT Act determines that the goods or services must be supplied for a consideration. 'Consideration' is also a defined term in section 1 of the VAT Act and will include any payment in any form.

It therefore appears that a cession of the right to receive a dividend, for a consideration, could qualify as a supply, by a vendor in the Republic, of a service in the course or furtherance of an enterprise, which is subject to the standard rate of 14%. Section 7 is, however, specifically subject to the exemptions contained in section 12 of the VAT Act. The requirements of section 7 should therefore be considered for each transaction in order to establish whether the transaction is subject to the VAT Act and if so, whether output tax will be levied at the standard rate, the zero rate, or whether the transaction will qualify as an exempt supply.

The cession of a right to receive a dividend is dependent on two other preceding factors, namely the existence of an equity share and the subsequent declaration of a dividend in respect of such equity share. The existence of an equity share entitles the holder thereof to the right to a declared dividend and is therefore considered as a condition before such right can be ceded. Furthermore, these factors could also constitute separate supplies and should be considered separately for VAT purposes.

The VAT implications of the following supplies are subsequently discussed in order to conclude on the VAT implications of a cession in particular:

- Transfer of ownership of equity shares
- Declaration of a dividend
- Cession of the right to receive a dividend

4.2. Transfer of ownership of equity shares

Section 1 of the VAT Act determines that a supply will occur when any goods or services are provided in the course of a business. Equity shares have been described as a bundle or conglomerate of personal rights (see *Standard Bank of South Africa Ltd and Another v Ocean Commodities Inc and Others* (1983:151)) and the granting, assignment or cession thereof will constitute services as defined in terms of section 1 of the VAT Act. On the assumption that the seller is a vendor and that the transfer of equity shares is a continuous, regular and ongoing activity for consideration, it appears that the transfer of an equity share complies with the requirements of section 7 of the VAT Act and could be subject to a liability for output tax at the standard rate.

It must therefore be determined whether any of the exemptions contained in section 12 of the VAT Act applies. Relevant to equity shares is section 12(a) of the VAT Act which provides that the supply of financial services will be an exempt supply. In turn, section 2 of the VAT Act determines what will constitute financial services. Of interest to this research is section 2(1)(d) of the VAT Act which determines that the issue, allotment or transfer of the ownership of an equity security will be financial services. An 'equity share' is defined by section 2 of the VAT Act as an interest or right to share in the capital of a juristic person. 'Capital' is not defined in the VAT Act, but the Supreme Court of Appeal was called to interpret the meaning of 'equity shares' in *TCT Leisure*

(Pty) Ltd v Commissioner for the South African Revenue Services (2010). The court (at 6) held that, in order to establish whether a supply is the supply of equity shares, the company's articles and memorandum must be examined to identify the rights which form part of the bundle of incorporeal rights which comprises a share in the relevant company. Should the supply under consideration not be the supply of such a right, that supply will not be that of an equity share. However, the court was not called upon to decide on the meaning of the phrase 'the capital of a juristic person' as the taxpayer could not prove that the supply was as an incident of share ownership. In the case of a cession of the right to receive a dividend the supply will be the supply of a part of the bundle of incorporeal rights which comprises a share. What remains to be determined, however, is whether such a supply would also constitute the supply of an equity share, in other words whether the right to receive a dividend is a right to share in the capital of a juristic person. The Oxford Dictionaries (Oxforddictionaries.com, n.d.) define 'capital' as wealth in the form of money or assets which is available for purposes such as starting a company or investing, or it could indicate the excess of a company's assets over its liabilities. It is submitted that the right to a share in the capital of a juristic person therefore refers to a right to the excess of the assets over the liabilities of that juristic person, which is a right attaching to a share as determined in *Standard Bank of South Africa Ltd and Another v Ocean Commodities Inc and Others* (1983:151), which is distinct from a right to receive dividends. Furthermore, should the legislature have intended equity share to include all the rights attaching to a share of a juristic person, it is submitted that the words 'in the capital of' would have been omitted.

The transfer of the ownership of equity shares, meaning the transfer of the right to the assets less the liabilities of a juristic person, will therefore constitute the supply of exempt financial services for VAT purposes. The VAT implications in respect of the declaration of dividend are considered next.

4.3. Declaration of a dividend

Dividends can be declared to be paid in cash, or in a form other than cash (a so-called dividend *in specie*). The provisions of the VAT Act relating to the declaration of a dividend in cash, or otherwise, are discussed subsequently.

4.3.1. Dividend other than a dividend *in specie*

It follows from the discussion above that the declaration of a cash dividend will be a supply for VAT purposes, due to the wide definition of 'supply' in section 1 of the VAT Act. The next requirement to be considered is whether such a supply will be the supply of goods or services.

The definitions of both 'goods' and 'services' specifically exclude money. The supply of money will consequently not be subject to the provisions of the VAT Act. In *Commissioner for South African Revenue Service v British Airways Plc* (2005:13) it was confirmed that section 7 of the VAT Act levies tax on the supplies of services and not merely on the receipt of money that arises from the supply of a service. In the current case no liability for output tax will therefore arise as the dividend takes the form of a payment of money which is not a taxable supply for purposes of the VAT Act.

KPMG (1997) argues, in the alternative, that a cash dividend could be seen to be the making available of an advantage, which is included in the definition of 'services' in section 1 of the VAT Act. However, it is stated that the shareholder receiving a cash dividend does not provide anything in order to receive that cash dividend and the supply is therefore not for a 'consideration' as is required by the definition of an 'enterprise' in terms of section 1 of the VAT Act. The result is that there will not be a taxable supply.

It follows that, irrespective of which of the abovementioned two alternative arguments are accepted, a dividend in cash will not constitute a taxable supply for VAT purposes. Where a dividend takes the form of a dividend *in specie* the VAT implications must be reconsidered as the supply would no longer constitute the supply of money.

4.3.2. Dividend *in specie*

The supply of a dividend *in specie* would be the supply of goods and could potentially be subject to a liability for output tax at the standard rate in terms of section 7 of the VAT Act. What must be determined is whether the supply of a dividend *in specie* would be in the course or furtherance of an enterprise. With regard to a cash dividend, it is argued that the shareholder has not provided any consideration for the receipt of the dividend and therefore the supply was not in the course or furtherance of an enterprise as defined in section 1 of the VAT Act.

Viviers (2015) submitted that a dividend *in specie* would constitute a supply for no consideration, which would not be subject to a liability for output tax in terms of section 7 of the VAT Act. However, where the supply is between connected persons, the position may differ as a result of the provision contained in section 10(4) which deems a supply between connected persons to have been supplied at market value. In such a case the supply might therefore be for a consideration and could result in a liability for output tax at the standard rate as determined by section 7 of the VAT Act.

The difference in the treatment between a connected and unconnected person in the case of a dividend *in specie* may, however, be irrelevant due to the so-called 'change in use' provisions. One such a provision is section 18(1) of the VAT Act which is applicable where goods were acquired for use in the course and furtherance of an enterprise of a vendor, but are subsequently used to make exempt or non-taxable supplies. It would appear that a vendor who acquires goods to use in the course and furtherance of his enterprise, who subsequently distributes those goods to shareholders, as a dividend *in specie*, could constitute a change in use and section 18(1) of the VAT Act would cause a liability for output tax to arise.

In conclusion, and concurring with the findings of Viviers (2015), a dividend *in specie* would likely result in a liability for output tax for the declaring company of that dividend *in specie.*

4.4. Cession of a right to receive a dividend

The transfer of equity shares and the declaration of dividends (other than dividends *in specie*) would not result in a liability for output tax, either due to being an exempt supply or a non-taxable supply. The position with regard to a cession of the right to receive a dividend must however still be investigated with reference to the cedent, cessionary and declaring company involved in the cession (refer to **Figure 1.1** for an illustration of the basic structure of a cession of the right to receive a dividend), starting with the cedent since its liability for output tax could influence the VAT implications for the cessionary.

4.4.1. Position of the cedent

Specifically included in section 1 of the VAT Act as a supply, is the performance in terms of a sale agreement. A cession can take place upon mere agreement (see *Lynn & Main Inc v Brits Community Sandworks CC* (2008)) between the parties. Such cession would therefore qualify as a supply for VAT purposes. Furthermore, specifically included in the definition of services in section 1 of the VAT Act is the cession of any right. The cession of the right to receive a dividend would therefore be the supply of services and it is contemplated that such cession could form an activity which happens frequently and without interruption, for a consideration. Assuming that the cedent is a vendor, the cession of the right to receive a dividend would result in the supply of services in the course or furtherance of an enterprise, for a consideration. This supply will be subject to a liability for output tax at the standard rate, unless an exemption applies.

The exemption applicable to the transfer of equity shares (see 4.2 above) must be considered. As indicated, it was held in *Standard Bank of South Africa Ltd and Another v Ocean Commodities Inc and Others* (1983:151) that a share constitutes a bundle or conglomerate of personal rights, which entitles the holder thereof to an interest in the company, its assets and dividends. An equity share for purposes of section 2 of the VAT Act, however, refers only to the capital of the company. The cession of the right to receive a dividend consequently does not result in the issue, allotment or transfer of ownership in an equity security and will not be the supply of financial services.

In contrast with the transfer of equity shares and the declaration of a cash dividend (see 4.3), the cession of the right to receive a dividend would constitute a taxable supply of services and a liability for output tax for the cedent will arise.

4.4.2. Position of the cessionary

If the cedent must account for a liability for output tax on the cession of the right to receive a dividend, the cessionary would acquire services upon which VAT was charged. As stated in the VAT 404 Guide for Vendors, issued by SARS, where a vendor acquires goods or services to be used in conducting its business, the VAT charged will qualify to be claimed as an input tax deduction (SARS, 2015b:44). 'Input tax' is defined in section 1 of the VAT Act to mean the tax charged under section 7 of the VAT Act that is payable by a supplier on the supply of goods or services made by that supplier to the vendor. The definition goes on to determine that input tax will only be applicable where the goods or services are acquired by the vendor wholly for purposes of consumption, use or supply in the course of making taxable supplies.

Where the cedent accounted for output tax on the cession, and assuming the cessionary is also a VAT vendor, it must be determined whether the cessionary acquired the right to receive the dividend for purposes of consumption, use or supply in the course of making taxable supplies.

The cessionary could either use the right to receive a dividend to cede that right further, in which case it will become the cedent, or it could remain the holder of that right and will therefore receive dividends if so declared and paid. In the case where the dividend is further ceded by the cessionary, it will be making taxable supplies as determined in 4.4.1. In such a case the cessionary will be using the right to make taxable supplies and an input tax deduction should be allowed in terms of section 16(3) of the VAT Act. Where the cessionary remains the holder of the right and subsequently receives a dividend, it must be considered whether the cessionary has made a taxable supply. As noted above, a supply is widely defined and includes the provision of any goods or services. It is submitted that the receipt of a dividend, in cash or otherwise, will not amount to the provision of goods or services by the holder of the right to receive the dividend and therefore the holder of the right will not be using the right in the course of making taxable supplies. It follows that no input tax deduction would be allowed.

4.4.3. Position of the declaring company

The declaration of a dividend, other than a dividend *in specie*, will not be a taxable supply (see 4.3.1 above). However, the position with regard to a dividend *in specie* differs. As mentioned in 0 above, it has been determined that a dividend in the form of a dividend *in specie*, where the asset was used in the course and furtherance of an enterprise by the declaring company, would be subject to a liability for output tax at the standard rate. The declaring company would have to account for the liability for output tax.

The initial cession of the right to receive that dividend between the cedent and cessionary will, however, also be subject to a liability for output tax at the standard rate. A situation could exist where the cessionary acquires the right to receive a dividend for a consideration which includes VAT at the standard rate. Subsequently, if the relevant company declares a dividend *in specie,* that company will have to account for the liability for output tax thereon once again. However, the cessionary will not be allowed to claim an input tax deduction at any time.

The findings of the VAT implications of a cession of the right to receive a dividend are submitted in **Table 4.1** below.

Table 4.1: Summary of Value-Added Tax implications of a cession of the right to receive a dividend

Person	Cession of the right to receive a dividend	Declaration and receipt of a dividend
Cedent	Where the cedent is a vendor, the cession of the right to receive a dividend could result in the supply of services in the course and furtherance of an enterprise, for a consideration, which would be subject to a liability for output tax at the standard rate.	The cedent would not receive the dividend as the cessionary will be entitled thereto.
Cessionary	Where the cessionary acquires the right to receive a dividend and subsequently receives a dividend, the cessionary does not utilise the right to receive a dividend in the course of making taxable supplies, and no input tax deduction will be allowed.	Where the cessionary receives a dividend, either in cash or *in specie*, no input tax deduction will be allowed.
Declaring company	A cession of the right to receive a dividend does not concern the company.	The declaration of a dividend, other than a dividend *in specie*, will not be a taxable supply. The declaration of a dividend *in specie*, however, results in a taxable supply where the asset that is declared was used in the course and furtherance of an enterprise by the declaring company.

Source: Author’s compilation

CHAPTER 5

DONATIONS TAX IMPLICATIONS OF A CESSION OF THE RIGHT TO RECEIVE A DIVIDEND

5.1. Background

The Income Tax Act provides for the levy of Donations Tax at a rate of 20% on the value of any property disposed of under any donation as set out in Part V of the IT Act, consisting of sections 54 to 64.

A donation is defined in section 55 of the IT Act to mean a gratuitous disposal of property. The Oxford Dictionaries (Oxforddictionaries.com, n.d.) define gratuitous as 'done without good reason', 'uncalled for' or 'given free of charge'. The test to determine whether a disposition amounts to a donation under common law was confirmed by Marais JA in *Welch v CSARS* (2004:22) as whether it was motivated by 'pure liberality' or 'disinterested benevolence'. It is submitted that when determining whether a disposition amounts to a donation, in other words whether the disposition is gratuitous, regard would be given to the ordinary dictionary meaning of the word as well as the common law test.

Even where a disposition is not gratuitous, Donations Tax could still be levied in terms of section 58 of the IT Act if the Commissioner of SARS is of the opinion that the consideration received for the disposal does not reflect adequate consideration. The term 'adequate consideration' is not defined in the IT Act, but it was held by the Tax Court in *ITC 1599* (1995:98) that an enquiry of whether there was adequate consideration would entail a comparison between the fair market value of the asset disposed of and the fair market value of the consideration received. The court further held that the provisions of section 62 of the IT Act should be considered when determining the fair market value of the property. The term 'adequate consideration', however, does not necessarily mean 'fair market value' and commercial considerations could justify transactions which are concluded at less than market value (De Koker & Williams, 2016b:23.5). It is noteworthy that De Koker and Williams (2016b:23.5) state that section 58 of the IT Act does not compel the Commissioner of SARS to act, and on this basis section 58 of the IT Act is usually not invoked where assets are transferred for less than market value between a company and its sole beneficial shareholder, provided that there is not enrichment of any person. Whether the Commissioner of SARS will invoke section 58 of the IT Act therefore depends on the facts and circumstances of each case. It is submitted that the fair market value, with reference to the provisions of section 62 of the IT Act, would still be the starting point when the Commissioner of SARS considers exercising his discretion under section 58 of the IT Act.

It has been established that the right to receive a dividend could be either a personal or real right. The Donations Tax implications of a cession of the right to receive a dividend will be discussed below, with reference to the distinction between personal rights and real rights where applicable.

5.2. Cession of the right to receive a dividend

In the Explanatory Memorandum on the TLAA 2012, SARS (2012:32) notes that section 64EB of the IT Act was inserted as result of a scheme that was identified where foreign shareholders could reduce the dividends tax liability to zero without relying on a double tax agreement. The scheme entailed that the foreign shareholder would sell, for a consideration, the right to receive a dividend to an independent South African resident company. As the right to receive a dividend would be sold for a market-related consideration, it would not amount to a gratuitous disposal and the consideration would be adequate consideration. Therefore such an instance would not constitute a donation or deemed donation. It is, however, contemplated that a scenario could exist where the shareholder could cede the right to receive a dividend to a resident company for no consideration or for a consideration which is not adequate in the opinion of the Commissioner of SARS. In such a case the cedent would be donating, or be deemed to donate, an asset to the resident company.

It follows that the Donations Tax provisions could be applicable to a cession of the right to receive a dividend. While the focus in this chapter is on the Donations Tax implications, the Normal Tax and Dividends Tax implications of a cession of the right to receive a dividend are discussed in Chapters 6 and 7. It has been established that the right to receive a dividend could be ceded as a personal right or a real right, which would have an influence on the valuation of the right for purposes of Donations Tax. The Donations Tax implications of a cession of the right to receive a dividend as either a personal right or real right are therefore examined below.

5.2.1. Cession of the right to receive a dividend as a personal right

The right to receive a dividend could constitute a personal right, such as a contractual right between the cedent and the cessionary. When such a right is donated, its value must be determined with reference to the provisions of section 62 of the IT Act. Section 62(1)(a) of the IT Act sets out a specific method for determining the value to be placed on a 'usufructuary or like interest in property'. De Koker and Williams (2016c:23.6) argue that a usufruct is a real right and that the term 'like interest' must accordingly be interpreted as referring to a real right and not merely a contractual right. Where the right is a personal right, the provisions of section 62(1)(a) of the IT Act are therefore not applicable.

Section 62(1)(d) of the IT Act would, however, be applicable in terms of which the value to be placed on the donation will be the fair market value of the property. For purposes of Donations Tax the phrase 'fair market value' is defined in section 55 of the IT Act as the price which could have been obtained between a willing buyer and a willing seller, dealing at arm's length, in the open market. When determining the Donations Tax implications of a cession of the right to receive a dividend, the cedent will therefore have to determine the fair market value of the right to receive a dividend.

5.2.2. Cession of the right to receive a dividend as a real right

Where a right constitutes a real right that provides a person with the right of enjoyment of income over the shares of another, that right will constitute a usufruct or other like interest (De Koker & Williams, 2016c:23.6). For purposes of Donations Tax, section 62(1)(a) of the IT Act deems the value of a usufruct or 'like interest' in property to be an amount determined by capitalising at 12% the annual value of the right of enjoyment of the property over which such interest was or is held, over the expectation of life of the donor, or if the right is to be held for a lesser period, over that period. It follows that, where the right to receive a dividend which is donated constitutes a real right that provides the cessionary with the enjoyment of the income of the shares of the cedent, the provisions of section 62(1)(a) of the IT Act would apply to determine the value of the property donated.

Section 59 of the IT Act places the liability for Donations Tax on the donor, provided that the liability shall be jointly and severally on the donor and the donee where the donor fails to pay the Donations Tax within the prescribed period. The liability to pay Donations Tax will therefore be firstly on the cedent, but should the cedent fail to pay the Donations Tax prior to the end of the month following the month during which the donation was made, the cessionary will be jointly and severally liable. The Donations Tax implications, summarised in **Table 5.1** below, could therefore be applicable to either the cedent or the cessionary.

Table 5.1: Donations Tax implications of a cession of the right to receive a dividend for no, or inadequate, consideration

Right to receive a dividend as a personal right	**Right to receive a dividend as a real right**
The value on which Donations Tax will be calculated will be the fair market value, which must be calculated as the price which could be obtained between a willing buyer and a willing seller dealing at arm's length in the open market.	The value on which Donations Tax will be calculated will be an amount determined by capitalising at 12% the annual value of the right of enjoyment of the property over which such interest was or is held, over the expectation of life of the donor, or if the right is to be held for a lesser period, over that period.

Source: Author's compilation

CHAPTER 6

NORMAL TAX IMPLICATIONS OF A CESSION OF THE RIGHT TO RECEIVE A DIVIDEND

6.1. Background

Normal Tax, according to section 5(1) of the IT Act, is an Income Tax levied in respect of taxable income received by, or accrued to, or in favour of, any person or company. The first step in determining whether an amount is to be included in the taxable income of a person is to establish whether that amount constitutes gross income of that person. Specifically excluded from the definition of gross income is any receipt or accrual which is of a capital nature. It is therefore important to establish the nature of a receipt or accrual.

The IT Act does not contain a definition for when an amount will be of a 'capital nature', but the South African courts have developed guidelines which can assist in determining whether an amount is revenue or capital in nature. These guidelines are discussed, with supporting authority, in the Tax Guide for Share Owners (SARS, 2014). From the guide and supporting authority, the conclusion is drawn that the most important factor to be considered is the taxpayer's intention at the time that the asset was purchased and sold (SARS, 2014:3–4). The test of the taxpayer's intention provides that should the asset have been bought with the intention to be held as a long-term investment, the proceeds upon disposal thereof is likely to be capital in nature. In contrast, should the asset have been bought with the intention of resale, the proceeds will likely be revenue in nature. Establishing the intention of a taxpayer is not always a simple task and for this purpose the courts have laid down the following circumstances which generally indicate whether proceeds are revenue or capital in nature (SARS, 2014:4–6). Firstly, it must be evaluated whether the taxpayer disposed of the asset in a so-called 'scheme of profit-making'. A scheme of profit-making will exist where the purchase of an asset is for the purpose of resale, in which circumstances the proceeds are likely to be revenue in nature. In contrast, a fortuitous gain, being a gain which is not designedly sought and worked for, will be capital in nature. Other circumstances could exist which indicate that the asset was acquired and held 'for keeps', in other words the asset was acquired and held for better or worse. In such circumstances the proceeds from the disposal of that asset are likely to be capital in nature. None of the factors and circumstances is conclusive and each instance must be determined with reference to its own circumstances and the intention of the taxpayer should be established with regard to all relevant factors.

A share is a complex bundle of rights, one of which entitles the registered shareholder to receive dividends. When the right to receive a dividend is ceded, a part of the share is disposed of. In order to determine whether the proceeds received will be capital or revenue in nature, the intention of the taxpayer with the share, as asset of which a part is disposed of, must be determined. Specifically with regard to equity shares the IT Act contains section 9C which deems the proceeds from the disposal of a 'qualifying share' to be of a capital nature in certain circumstances. A 'qualifying share' is defined in section 9C of the IT Act to mean an equity share which has been disposed of by a taxpayer who, immediately prior to such disposal, had been the owner of that share for a continuous period of at least three years. Where a cedent has held a share for more than three years and subsequently disposes of a part of that share, by way of a cession of the right to receive a dividend, it is submitted that the receipt or accrual will be of a capital nature. The Capital Gains Tax implications of such a case are discussed below as section 26A of the IT Act provides that a person must include his taxable capital gain in his taxable income.

Should the share be held for less than three years and it is found that the receipt or accrual is not capital in nature, the receipt or accrual will be included in the gross income of the cedent. To determine the Normal Tax implications hereof it must be determined whether the receipt could qualify for an exemption. Specifically it will be investigated whether the receipt or accrual could constitute exempt income in terms of section 10(1)(k) of the IT Act, which provides an exemption for the receipt of dividends. Where the receipt or accrual is not exempt it must be determined whether any deductions as indicated in Part I of Chapter II of the IT Act are applicable. The applicability of section 11(a) of the IT Act, which provides for a deduction against the income of a person for any expenditure or losses actually incurred in the production of income, provided that such amount is not of a capital nature, is subsequently considered.

To summarise, the Normal Tax implications of a cession of the right to receive a dividend are examined below with reference to the tax implications when the receipt or accrual is of a revenue nature or a capital nature. Furthermore, it has been established that a cession of the right to receive a dividend can constitute either a personal right or a real right (in the form of a usufruct), depending on the circumstances of each case. Accordingly, the Normal Tax implications of both scenarios in the case of a revenue and capital receipt or accrual were investigated. The structured investigation in this chapter is as follows:

- The position of the cedent if the receipt is revenue in nature;
- The position of the cedent if the receipt is capital in nature (with the necessary distinction between a real and a personal right);
- The position of the cessionary if the receipt is revenue in nature; and
- The position of the cessionary if the receipt is capital in nature (with the necessary distinction between a personal right and a real right).

6.2. Position of the cedent – receipt revenue in nature

Where a taxpayer acquires a share with the intention of disposing of a part thereof for a profit, in other words utilising that right in a scheme of profit making, the receipt or accrual for the disposal will likely be revenue in nature. The amount received must therefore be included in the gross income of the cedent. The next step would be to determine whether the amount constitutes income of the cedent, or whether a possible exemption from Normal Tax applies. The exemption contained in section 10(1)(k) of the IT Act applies to the receipt of a local dividend, while a foreign dividend could be entirely or partially exempt in terms of section 10B of the IT Act. It therefore follows that it must be determined whether the receipt will constitute a dividend or foreign dividend.

A dividend is defined in section 1 of the IT Act and refers to an amount transferred or applied by a company for the benefit of any person in respect of any share in that company. A foreign dividend is defined in section 1 of the IT Act and is generally an amount that is paid or payable by a foreign company in respect of a share in that foreign company. In the case of a cession of the right to receive a dividend, the amount received by the cedent is received from the cessionary as consideration for the disposal of the right to receive the dividend. The amount is not transferred or applied by a company in respect of any share in that company, nor is it paid or payable by a foreign company in respect of a share in that foreign company. The exemptions contained in sections 10(1)(k) and 10B of the IT Act will therefore not apply. It follows that the amount received by the cedent will constitute income of the cedent.

The next step in calculating the taxable income of the cedent, as a result of the cession of the right to receive a dividend, will be to consider whether a deduction, as provided for in section 11(a) of the IT Act, will be allowed. In other words, it must be considered whether the taxpayer has actually incurred expenditure in the production of income which could qualify as a deduction. Where a person incurs expenditure in the production of gross income which is exempt from Normal Tax, such as expenditure incurred in the acquisition of a share which will produce exempt dividends, the expenditure will not qualify as a deduction as it will not have been incurred in the production of income. In other words, expenditure incurred to acquire shares, which provides gross income in the form of exempt dividends, will generally not qualify as deductible expenditure. However, it is contemplated that a cedent could acquire the share, which includes the right to receive dividends, with the intention of earning taxable income by ceding the right to receive a dividend. In such a case it could be possible to claim a deduction for a portion of the acquisition cost of the share under section 11(a) of the IT Act. The amount of a deduction will be the expenditure actually incurred in the production of income, as provided for in section 11(a) of the IT Act.

With regard to a share, the expenditure actually incurred to acquire the share will have been incurred to acquire the entire bundle of rights that constitute that share, which includes all the rights attaching to a share as determined in *Standard Bank of South Africa Ltd and Another v Ocean Commodities Inc and Others* (1983:151), such as an interest in the company, its assets and dividends. The expenditure incurred to acquire the right to receive the dividend therefore constitutes only a portion of the total expenditure incurred to acquire the share. Where a dividend has been declared prior to the purchase of a share, it is contemplated that the purchase price of the share would take into account the value of the dividend that is to be received and the expenditure incurred for the right to receive that, and future, dividends will be larger than in the case of no declared dividend. Where no such dividend has been declared, the share would still entitle the purchaser to all future dividends and therefore any expenditure incurred would include a portion which is expended to acquire the right to receive a dividend. The Supreme Court of Appeal in *CSARS v Mobile Telephone Networks Holdings (Pty) Ltd* (2014:12) confirmed that expenditure laid out for a mixed purpose, in other words in the production of income and otherwise, may be apportioned. Where a share is acquired with the intention of ceding a portion of that share in the production of income, an apportionment of the expenditure actually incurred could be made. It is therefore possible that a portion of the expenditure actually incurred by a taxpayer to acquire a share could be deductible in the case of a cession of the right to receive a dividend. In this regard it should be noted that section 102(1)(b) of the Tax Administration Act No. 28 of 2011 places the burden of proving that an amount is deductible on the taxpayer. In other words, the taxpayer must be able to prove that the apportionment amount reflects the deductible amount. The amount remaining after deducting the relevant amount will reflect the taxable income of the cedent which will be subject to Normal Tax in terms of section 5 of the IT Act.

The above is not applicable where the receipt or accrual is capital in nature. The second situation which was investigated is where the cedent acquires and holds the share as a capital investment and merely realises a fortuitous profit upon disposal of a part thereof. The Normal Tax implications for the cedent are discussed next.

6.3. Position of the cedent – receipt capital in nature

Where a taxpayer acquires and holds a share as a capital asset and realises a fortuitous gain upon its disposal, or the disposal of a part thereof, the amount received by or accruing to that taxpayer will likely be capital in nature. The definition of gross income specifically excludes receipts or accruals of a capital nature and therefore the amount received for a cession of the right to receive a dividend will not be included in the gross income of that taxpayer. An amount received which is of a capital nature must be considered in terms of the Schedule for Capital Gains Tax purposes in terms of which an amount is to be included in taxable income as a result of section 26A of the IT Act. As provided for in paragraph 3 of the Schedule, a person's capital gain, upon the disposal of an asset, is the amount by which the proceeds exceed the base cost of that asset. For a capital gain, or capital loss, to arise there must be an 'asset' and a 'disposal' each of which is subsequently considered. It has further been established that the right to receive a dividend could constitute either a personal right or a real right, both of which are considered below.

6.3.1. Right to receive a dividend as a personal right

The term 'asset' is broadly defined in paragraph 1 of the Schedule and includes property of whatever kind, irrespective of whether that property is movable or immovable, corporeal or incorporeal. The Comprehensive Guide to Capital Gains Tax (SARS, 2015a:39) contains a list of examples of assets, which list specifically includes shares. The definition of 'asset' in paragraph 1 of the Schedule further provides that any right or interest of whatever nature in any property that qualifies as an asset will also constitute an asset. It follows that the right to receive a dividend, being a right or interest in a share, will qualify as an asset for purposes of the Schedule.

The definition of 'disposal' in paragraph 1 of the Schedule refers to paragraph 11 of the Schedule, which contains the provisions that determine what will constitute a disposal. Of particular interest is paragraph 11(1)(a) of the Schedule which provides that any cession of ownership of an asset will be a disposal. Where a right to receive a dividend (the asset) is ceded (the disposal), a Capital Gains Tax event will arise.

However, the right to receive a dividend can be equated with the right to claim payment from the company, if a dividend is declared. The Comprehensive Guide to Capital Gains Tax (SARS, 2015a:45) states that the right to claim payment, as a personal right, would not always be an asset for Capital Gains Tax purposes. This statement is in line with the reasoning of Cassidy as expressed by Swart (2005:2), that personal rights which are not capable of transmission or valuation, do not constitute assets for Capital Gains Tax purposes. With the creation of personal rights, the common thread of events which would qualify as assets is that the creation must result in a loss, limitation, restriction or diminution of the disposer's rights (Swart, 2005:8). Where the right to receive a dividend is ceded in terms of a contract between the cedent and the cessionary, it is submitted that a personal right will be created in terms of which the cessionary can oblige the cedent to perform. The personal right will therefore result in a limitation or diminution of the cedent's rights attaching to the share and it will constitute an asset which is disposed of for Capital Gains Tax purposes. In terms of paragraph 3 of the Schedule the cedent must determine the capital gain realised on that disposal, which will be equal to the amount by which the proceeds exceed the base cost.

The proceeds in respect of the disposal of an asset are governed by paragraph 35 of the Schedule which stipulates that proceeds are the amount received by or accrued to a person in respect of a disposal. The proceeds from a cession of the right to receive a dividend should therefore be equal to the amount received. Circumstances could, however, exist where an asset is disposed of by means of a donation, or between connected persons for proceeds less than the arm's length consideration that would have been agreed upon between independent persons contracting in the open market. In the case of a donation, or where the disposal takes place between connected persons, the proceeds will be deemed, to be the market value, as stated in paragraph 38(1) of the Schedule. The market value of an asset must be determined with reference to paragraph 31 of the Schedule. Paragraph 31(1)(g) provides that, for assets to which paragraphs 31(1)(a) to (f) do not apply, the market value will be equal to the amount which could have been obtained between a willing buyer and willing seller who are dealing at arm's length in the open market.

The base cost of an asset is calculated in terms of paragraph 20 of the Schedule. Paragraph 20 of the Schedule provides that the cost incurred to acquire and improve an asset will, in most instances, represent its base cost. In the case of a donation, paragraph 22 provides a formula in terms of which Donations Tax is taken into account when determining the base cost of an asset. In the current case the cost to acquire the right to receive the dividend must therefore be established. When the cedent purchases a share, a cost is incurred to purchase all the rights attaching to that share. When the right to receive a dividend from that share is subsequently disposed of, it is the base cost of that right that must be determined and not the base cost of the entire share. The Comprehensive Guide to Capital Gains Tax (SARS, 2011:244) states that the disposal of a future dividend stream constitutes a part disposal of the share.

Therefore the provisions of paragraph 33 of the Schedule, which contains the method for determining the base cost of the part disposed of in a part-disposal, must be applied. In terms of paragraph 33(1) of the Schedule the base cost attributable to the part disposed of must be calculated as the market value of the part disposed of, divided by the total market value of the asset (the share), and multiplied by the base cost of the entire asset.

For purposes of determining the proceeds and base cost of the right to receive a dividend, the cedent will therefore have to determine the market value of the right to receive a dividend and the market value of the share. Once this has been done, the cedent can determine the capital gain it realises as a result of the disposal of the asset. Section 102(1)(e) of the Tax Administration Act No. 28 of 2011 places the burden to prove that a valuation is correct on the taxpayer. The burden of proof will therefore be on the cedent.

Where the right to receive a dividend is not a personal right, but rather a real right, the calculation of the proceeds and base cost will differ from the above and is considered below.

6.3.2. Right to receive a dividend as a real right

Where the right to receive a dividend is a real right the cession could result in a usufruct. The Comprehensive Guide to Capital Gains Tax (SARS, 2015a:314) states that the sale of a future dividend stream is a quasi-usufruct. As with a personal right, the capital gain would be the amount by which the proceeds exceed the base cost. The determination of the proceeds and base cost will be the same as with a personal right with the exception of the calculation of the market value of the part being disposed of. Paragraph 31(1)(d) specifically provides a method for calculating the market value of usufructuary or similar interest in an asset. In terms of paragraph 31(1)(d) of the Schedule, the market value of a usufruct or similar interest must be determined by capitalising, at 12%, the market value of the full ownership of the asset over the expected life of the person who acquires that right, or if the right is to be held for a lesser period, over that period. Paragraph 31(2) of the Schedule further provides that the annual value of the right to enjoyment of the asset of 12% may be reduced to a reasonable yield if the Commissioner is satisfied that the annual yield from the asset could not reasonably be equal to 12%. The market value of the right to receive a dividend will therefore be calculated with reference to the expected yield of the share.

The above determination of the capital gain must be contrasted with the findings in Binding Private Ruling 089, dated 12 July 2010 and issued by SARS (SARS, 2010). Even though Binding Private Rulings are only binding between the parties to the ruling, they indicate the interpretation of SARS in relation to the specific facts of that case. The subject of this ruling was a series of transactions, one of which was that the applicant would, upon the issue of shares, waive its rights to future dividends. In the ruling it was decided that the waiver of future dividend rights would not be a disposal under paragraph 11(1)(b) of the Schedule, nor would it be a part disposal under paragraph 33 of the Schedule. This ruling appears to be at odds with the conclusion reached above and the view expressed in the Comprehensive Guide to Capital Gains Tax (SARS, 2011:244). It is not clear how the ruling was reached or the facts which gave rise to the conclusion and such a ruling should be approached with caution before relying thereon.

The Normal Tax implications of the cession of the right to receive a dividend for the cedent were investigated with regard to the position where the receipt or accrual is of a revenue nature or a capital nature. The Normal Tax implications of the cession of the right to receive a dividend for the cessionary are therefore considered below.

6.4. Position of the cessionary – acquired the right with revenue intention

Where a cessionary acquires the right to receive a dividend for the purpose of deriving revenue therefrom, in the form of dividends, any expenditure incurred will not be deductible under section 11(a) of the IT Act, as the receipt of dividends would generally be exempt from Normal Tax as a result of section 10(1)(k) of the IT Act. Therefore the share would not have been acquired in the production of income, as defined. However, as indicated in 7.1.2 of this thesis, in the discussion of the tax implications of the receipt of a dividend as a result of a cession, there are cases, such as a resident company receiving a dividend as a result of a cession, where the receipt of a dividend will not be exempt from Normal Tax. In such instances, subject to the requirements of section 11(a), it could be possible to claim a deduction for the expenditure incurred to acquire that right, as that right is used in the production of income.

It is further contemplated that a scenario could exist where the cedent provides the right to receive a dividend as consideration for the purchase of an asset from the cessionary. In *Cactus Investments (Pty) Ltd v CIR* (1996:187) Wunsh J gave the example of a tailor providing a suit in exchange for the right to receive a dividend. In other words, the cedent purchases a suit from the tailor, as cessionary, and provides the right to receive a dividend as consideration. Wunsh J held that the right to receive a dividend, as consideration for the supply of the suit, accrued to the tailor as income as it was not received merely as result of shareholding. The value of the right to receive the dividend will therefore be subject to Normal Tax for the tailor (the cessionary) and the income would not be regarded as exempt income. It follows that the receipt of the dividend by the cessionary, or his accrual of the right to receive the dividend, is to be included in his income, even though his receipt of the future dividend may be exempt.

It is further possible that a cessionary could acquire the right to receive a dividend with the intention of again disposing thereof (thereby becoming the cedent) in a scheme of profit-making. The expenditure actually incurred could then be deductible, should the requirements of section 11(a) of the IT Act be adhered to.

6.5. Position of the cessionary – acquired the right with capital intention

Where the cessionary acquires the right to receive a dividend as a capital asset, it will acquire that right with a base cost equal to the amount of expenditure actually incurred. Should the transaction take place as a donation, or between connected persons where the consideration does not reflect an arm's length price, the base cost will be deemed to be the market value of that right, as articulated in paragraph 38 of the Schedule It is contemplated that the cessionary could acquire the right to receive a dividend only for a specified period. Upon expiry of that period a disposal will take place, as contemplated in paragraph 11(1)(b) of the Schedule. On the date of expiry the right would have no value and the proceeds for the expiry would be zero, resulting in a capital loss for the cessionary.

Where the right to receive a dividend constituted a usufruct, paragraph 15(c) of the Schedule must be considered. Paragraph 15(c) of the Schedule applies to capital losses realised from any usufructuary or similar interest, of which the value decreases over time. The effect of paragraph 15(c) of the Schedule will be that any capital loss realised must be disregarded in determining the capital gain or loss of the cessionary.

The findings of the Normal Tax implications of the cession of a right to receive a dividend are submitted in **Table 6.1** below.

Table 6.1: Summary of the Normal Tax implications of a cession of the right to receive a dividend

Person	Receipt or accrual *revenue* in nature	Receipt or accrual *capital* in nature	
		Personal right	**Real right**
Cedent	The receipt or accrual will be included in gross income and will not be exempt; therefore the amount will constitute income of the cedent. A deduction of a portion of the acquisition cost of the share may be possible.	The personal right will constitute an asset which is disposed of. The capital gain will be calculated as the proceeds less the base cost. As the cession will constitute a part disposal of the share, an attribution of the base cost must take place with reference to the market value of the part disposed of and the market value of the share. The market value would be the price which could have been obtained between a willing buyer and willing seller who are dealing at arm's length in the open market.	The result of the disposal could be a usufruct. The capital gain of a usufruct will be calculated as the proceeds less the base cost. As the cession will constitute a part disposal of the share, an attribution of the base cost must take place with reference to the market value of the part disposed of and the market value of the share. The market value would be an amount determined by capitalising, at 12%, the market value of the full ownership of the asset over the expected life of the person who acquires that right, or if the right is to be held for a lesser period, over that period.

Person	Receipt or accrual *revenue* in nature	Receipt or accrual *capital* in nature	
		Personal right	**Real right**
Cessionary	The consideration (expenditure) incurred to acquire the right to receive a dividend will only be deductible if the underlying receipt of the dividend is taxable (therefore not exempt). The subsequent receipt of the underlying dividend is investigated in Chapter 7 and summarised in **Table 7.1**.	The expenditure actually incurred to acquire the right to receive a dividend would constitute the base cost of that asset. Upon the expiry of the right the cessionary will realise a capital loss.	Where the right to receive a dividend constitutes a usufruct, the expenditure actually incurred would constitute the base cost of the asset. Upon expiry of the right, the capital loss incurred will be disregarded.

Source: Author's compilation

CHAPTER 7

NORMAL TAX AND DIVIDENDS TAX IMPLICATIONS OF THE RECEIPT OF A DIVIDEND CEDED

7. Background

After a cedent cedes the right to receive a dividend to a cessionary, the cessionary could receive a dividend as a result of that cession. The Normal Tax and the Dividends Tax implications of the receipt of a dividend by the cessionary were investigated in this study and are subsequently discussed.

On 1 April 2012 Secondary Tax on Companies was replaced by Dividends Tax. The reason for the change is stated in the Quick Guide to Dividends Tax (SARS, 2013a:1) as a move to align South Africa with the international norm of taxing the recipient of the dividend and not the company paying the dividend. The provisions relating to Dividends Tax are contained in Part VIII of Chapter 2 of the IT Act, comprising section 64D to section 64N. Dividends Tax is a tax levied on the beneficial owner of a dividend (section 64EA and section 64EB of the IT Act) at a rate of 15% of the amount of any dividend paid by a company (section 64E of the IT Act), subject to certain exemptions (section 64F and section 64FA of the IT Act). The mechanism for payment of Dividends Tax, in the case of a dividend other than a dividend *in specie*, is by way of withholding by the company that declares and pays the dividend (section 64G of the IT Act).

For Dividends Tax to be applicable there must first be a dividend as defined. Section 1 of the IT Act defines a dividend to mean any amount which is transferred or applied by a resident company, for the benefit or on behalf of any person in respect of a share in that company. The definition of dividend specifically excludes situations where the amount transferred or applied results in the reduction of the contributed tax capital of a company, or where that amount constitutes a share in the company itself (a so-called capitalisation issue), or a repurchase of shares by a company in terms of the regulations of the Johannesburg Stock Exchange. Section 64D of the IT Act defines a dividend, specifically for purposes of Dividends Tax, as any dividend (as contemplated in section 1 of the IT Act) paid by a company that is a resident, or by a foreign company listed on the Johannesburg Stock Exchange. As confirmed in the Comprehensive Guide to Dividends Tax, the definition of 'dividend' does not only include cash dividends but also the distribution of assets, or so-called dividends *in specie* (SARS, 2015b:34). A resident company paying an amount to its shareholders, in respect of their shares in that company, by way of a distribution will therefore be paying a dividend and the Dividends Tax provisions must be applied.

Section 64EA determines that, in the case of a dividend that is not a dividend *in specie*, the beneficial owner of the dividend will be liable for Dividends Tax. It is therefore important to establish the identity of the beneficial owner of a dividend. The term 'beneficial owner' is defined in section 64D of the IT Act as the person who is entitled to the benefit of the dividend attaching to a share. Where the cessionary has acquired the right to receive a dividend, the cessionary will be the person entitled to the benefit of the dividend attaching to the share and would therefore be the beneficial owner of that dividend and could possibly be liable for Dividends Tax. The nature, or entity form, of the beneficial owner is also important as section 64F and section 64FA of the IT Act contain certain exemptions from Dividends Tax, dependent on the nature of the beneficial owner. Section 64F of the IT Act contains a list of entity forms that would be exempt from Dividends Tax if that entity is the beneficial owner of the dividend. Included in this list is a company which is a resident, as stated in section 64F(1)(a) of the IT Act. In other words, subject to the provisions dealing with deemed beneficial ownership, a dividend paid to a resident company will be exempt from Dividends Tax.

In the case of a dividend *in specie*, section 64EA of the IT Act provides that the company that declares and pays the dividend will be liable for Dividends Tax, unlike the case with a dividend in cash where the beneficial owner is liable. Section 64FA, however, provides that a dividend *in specie* will be exempt from Dividends Tax if the beneficial owner has provided a declaration that the dividend would have been exempt had that dividend been a cash dividend. Accordingly, it is submitted that the provisions regarding the Dividends Tax liability of a dividend in cash would apply equally to a dividend *in specie*, with the exception of who the Dividends Tax liability falls on, therefore the investigation of the Dividends Tax implications for the cedent and cessionary herein will be limited to a dividend in cash.

The Explanatory Memorandum on the TLAA (SARS, 2012:32) states that the exemptions from Dividends Tax gave rise to avoidance schemes which involved a person, who would be subject to Dividends Tax, transferring its right to receive a dividend to a resident company, or other exempt entity, solely for the purpose of reducing or delaying the liability for Dividends Tax. To limit these avoidance schemes, section 64EB of the IT Act deems certain persons to be the beneficial owners of a dividend where a cession of the right to receive a dividend took place. Section 64EB(1) of the IT Act applies where a person who is exempt from Dividends Tax acquires a right to receive a dividend by way of a cession and the dividend was announced or declared prior to that cession. In such a case the person ceding the right to the dividend, that is to say the cedent, will be deemed to be the beneficial owner of that dividend, unless the cessionary holds all the rights attaching to that share after the cession. Where a person therefore cedes the right to receive a dividend after the dividend has been declared, that person will remain the beneficial owner for purposes of Dividends Tax. It is therefore necessary to distinguish between two scenarios regarding the timing of the cession:

- Cession **prior** to the declaration of the dividend; and
- Cession **after** the declaration of the dividend.

7.1. Cession prior to the declaration of the dividend

It has been accepted by the South African courts that the right to receive a future dividend is an existing right and can be validly ceded (*ITC 1378* (1983:234)). Even should it be determined that the right to receive a dividend does not constitute an existing right, but rather a mere hope or *spes*, it was held in *Lynn & Main Inc v Brits Community Sandworks CC* (2008) (Van der Merwe, 1998:362) that such a right can be validly ceded.

The Dividends Tax implications for both the cedent and the cessionary, where a dividend is received as a result of the cession of the right to receive that dividend, which cession took place prior to the declaration of that dividend, is discussed below.

7.1.1. Position of the cedent

Dividends Tax is a tax on the beneficial owner and where a company declares and pays a dividend that company must consider whether it must withhold Dividends Tax with reference to the beneficial owner of the dividend. The liability to withhold 15% of the amount of any dividend will arise unless the beneficial owner is an entity which is exempt in terms of section 64F of the IT Act. Where the cession took place before the dividend was announced or declared, the deemed beneficial owner rules contained in section 64EB will not be applicable and the cedent will not be deemed to be the beneficial owner of the dividend. The cessionary will therefore be the beneficial owner and Dividends Tax will not be applicable to the cedent.

Where a dividend is paid by a company, the company needs only be concerned with the registered shareholder (*Standard Bank of South Africa Ltd and Another v Ocean Commodities Inc and Others* (1983:289)) and will therefore pay such amount to the registered shareholder. Where a cession of the right to receive the dividend has taken place, the registered shareholder (as cedent) will have the obligation to pay such amounts to the beneficial owner. Confusion may arise where a valid cession has taken place and subsequently the dividend is physically received by the cedent (Croome, Oguttu, Muller, Legwaila, Kolitz, Williams & Louw, 2013:79). In order to determine whether the cedent will be subject to Normal Tax on an amount it receives, it must be determined whether that amount must be included in its gross income as defined in section 1 of the IT Act. The definition of gross income includes any amount which is received by a resident. It has been held that an amount will only be 'received by' a taxpayer if he receives that amount for his own benefit and on his own behalf (*Geldenhuys v CIR* (1947:431)). Where a cedent, as registered shareholder, receives a dividend on behalf of the cessionary, as beneficial owner, he will not receive that amount for his own benefit and on his own behalf and that amount cannot be included in his gross income (De Koker & Williams, 2016a:9.2). The cedent will therefore not be subject to Normal Tax on the amount.

It follows that, where a dividend is received as the result of a cession, where the cession took place before that dividend was announced or declared, the receipt of that dividend will not result in a Dividends Tax or Normal Tax liability for the cedent.

7.1.2. Position of the cessionary

Where a valid cession of the right to receive a dividend takes place prior to the announcement or declaration of a dividend, the cessionary will be the beneficial owner as he will be entitled to the benefit of any dividend attaching to that share. The cessionary would therefore be liable for Dividends Tax, unless it is an entity which is listed as an exempt entity in section 64F of the IT Act.

Where the cessionary, as the person who is entitled to the benefit of a dividend, receives a dividend for its own benefit and on its own behalf, that amount will be received by the cessionary as contemplated in the definition of gross income in section 1 of the IT Act. It must then be considered whether the amount will be subject to Normal Tax for the cessionary. In this regard section 10(1)(k) of the IT Act must be considered which provides that a dividend received by or accrued to a person is exempt from Normal Tax, unless one of the exclusions applies.

Relevant to this research is the exclusion contained in section 10(1)(k)(i)(*ee*) of the IT Act, in terms of which a dividend will not be exempt from Normal Tax if it is received by or accrued to a company in consequence of any cession of the right to receive a dividend. The exemption will however still apply where that cession results in that company holding all the rights attaching to the relevant share. The Explanatory Memorandum on the TLAA 2011 (SARS, 2012:60) states that this anti-avoidance measure was inserted as the cessionary is merely purchasing an income stream which is devoid of any meaningful stake in the underlying share. The reason for the anti-avoidance is that many companies were purchasing dividends through cessions solely to receive exempt income, while artificially using seemingly deductible finance schemes. The result was a disparity with companies receiving exempt income, but also claiming a deduction which undermined the tax system. The effect of section 10(1)(k)(i)(*ee*) of the IT Act is therefore that a dividend received by a company, as a result of a cession, would not be exempt from Normal Tax and would be included in income and subject to Normal Tax. The insertion of section 11(1)(k)(i)(*ee*) of the IT Act coincided with the amendment to the definition of security in the STT Act, which resulted in a cession of a right to receive a dividend no longer being subject to STT. The reason provided in the Explanatory Memorandum on the TLAA (SARS, 2011:172) for the amendment to the STT Act corresponds with the reasoning for section 10(1)(k)(i)(*ee*) of the IT Act in that it is stated that the receipt of a dividend, acquired by way of a cession, would result in an income stream independent from the underlying share which will be treated as ordinary revenue of the cessionary. It is however noteworthy that section 10(1)(k)(i)(ee) of the IT Act only applies to dividends received by companies, although the amendment to the STT Act will result in all dividend cessions not being subject to STT.

Where dividends are received as a result of a cession, the exclusion contained in section 10(1)(k)(i)(*ee*)(A) of the IT Act should be considered. The purpose of section 10(1)(k)(i)(*ee*)(A) is to deny the dividend exemption where a company receives a dividend but does not hold the underlying share (De Koker & Williams, 2016a:9.21). In other words, the amount received will be taxed as ordinary revenue, because the cessionary has no meaningful interest in the company paying the dividend (De Koker & Williams, 2016a:9.21). To achieve this purpose, section 10(1)(k)(i)(*ee*) of the IT Act determines that a dividend will not be exempt from Normal Tax where that dividend is received by or accrued to a company in consequence of any cession of the right to that dividend, unless the cession also results in that company holding all the rights attaching to a share. Accordingly, where the cessionary is a company, the dividend will not be exempt from Normal Tax and will form part of the income of that company, which is subject to Normal Tax.

7.2. Cession after the dividend has been declared

The second scenario that was investigated is where the cession of the right to receive a dividend takes place after the dividend has been announced or declared, which must be distinguished from the tax implications of the scenario where the cession takes place before the dividend has been announced or declared. The tax implication of the second scenario, that is to say where the right to receive the dividend is ceded after the declaration of that dividend, is subsequently discussed with reference to both the cedent and the cessionary.

7.2.1. Position of the cedent

When the right to receive a dividend is ceded after the dividend has been announced or declared, section 64EB of the IT Act becomes applicable. In terms of section 64EB of IT Act, the beneficial owner of a dividend will be deemed to be the cedent, if the person who acquires that right by way of the cession (in other words the cessionary) is an exempt entity as contemplated in section 64F and the cession takes place after the dividend has been announced or declared, unless the cession results in that person acquiring all the rights attaching to the share. For example, where a resident company receives a dividend as a result of a cession which took place after the dividend was announced or declared, the deemed beneficial owner of that dividend will be the cedent and not the receiving company. The Dividends Tax liability in such a case will therefore be determined with reference to the entity type of the cedent, and the tax liability, if any, will fall on the cedent. Where the cessionary is not an exempt entity, section 64EB will not apply and the beneficial owner of the dividend will be the cessionary, in which case the Dividends Tax liability will be on the cessionary.

As with the first scenario, it is contemplated that the company paying the dividends would pay the amount to the cedent as registered shareholder. It must then be determined whether the amount will form part of the gross income of the cedent. Where it has been determined that the cedent is the deemed beneficial owner for purposes of Dividends Tax, it is submitted that the fact that a person is the deemed beneficial owner does not influence the determination of whether an amount has been received by or has accrued to that person. Accordingly, if the cedent does not receive the dividend for his own benefit and on his own behalf, the dividend cannot be included in his gross income.

7.2.2. Position of the cessionary

Where the cessionary is an exempt entity and receives a dividend as a result of a cession after the dividend is announced or declared, it will not be the beneficial owner of that dividend as a result of section 64EB of the IT Act. In such an instance the Dividends Tax implications must be determined with reference to the cedent, as deemed beneficial owner, and any Dividends Tax liability will accordingly be on the cedent. Where section 64EB does not apply, in other words where the cessionary is not an exempt entity, the cessionary would be the beneficial owner and the liability for Dividends Tax would depend on whether the cessionary is an entity which is listed as an exempt entity in section 64F of the IT Act.

The Normal Tax implications arising from the receipt of a dividend by the cessionary as a result of a cession after the dividend has been announced or declared will be the same as the position where the cession took place before the dividend had been announced or declared. In other words, should the cessionary be a resident company, section 10(1)(k)(i)(*ee*)(A) of the IT Act will apply and the amount will not be exempt from Normal Tax. It is contemplated that a scenario could exist where a person cedes his rights to receive a dividend, after a dividend has been announced or declared, to a resident company. The result would be that the cedent will be the deemed beneficial owner and could be subject to Dividends Tax. The company will, however, receive the dividend, which amount will not be exempt from Normal Tax as a result of section 10(1)(k)(i)(*ee*)(A). Section 64F(1)(l) of the IT Act provides that an amount will not be subject to Dividends Tax to the extent that it constitutes income of that person. In the abovementioned scenario section 64F(1)(l) will, however, not provide any relief since the person liable for Dividends Tax and the person in whose income the amount is included are not the same person. The same amount would therefore be subject to tax in the hands of different taxpayers. As indicated in the Explanatory Memorandum on the TLAA 2012, section 64EB of the IT Act was inserted to close dividend conversion schemes (SARS, 2012:32). As indicated, the application of section 64EB could, however, give rise to a situation where the same amount is subject to tax twice, albeit it in the hands of different taxpayers. It has, however, been held that a taxpayer cannot argue that he should not be subject to tax on an amount merely because someone else may be paying tax on that same amount (see *ITC 554* (1944:213)).

The Dividends Tax and Normal Tax implications of the receipt of a dividend as a consequence of the cession of the right to receive a dividend have been investigated, as indicated above. In addition to the provisions considered above, the IT Act also contains a specific anti-avoidance provision which could be applicable where a taxpayer has exchanged his right to receive taxable income for the right to receive an exempt dividend. This provision is briefly discussed below.

7.3. Conclusion

From the discussion above it is evident that the receipt of a dividend, as a result of a cession, could be exempt from Normal Tax for the cessionary, for example the receipt of a dividend by an entity other than a resident company.

Section 103(5) of the IT Act contains a specific anti-avoidance provision that applies when a transaction, operation or scheme is entered into whereby a right to receive an amount is ceded in exchange for the right to receive an amount of exempt dividends, which results in the Normal Tax of a taxpayer or other party to the transaction being reduced or extinguished. The Explanatory Memorandum on the TLAA of 2011 (SARS, 2012:162) refers to the same reasoning as is provided for section 10(1)(k)(*ee*) discussed above; in other words the anti-avoidance measure of section 103(5) is aimed at preventing dividend cessions where the cessionary acquires no interest in the underlying share and the transaction is purely entered into to utilise the exempt nature of dividends in order to reduce a person’s taxable income. Where section 103(5) of the IT Act applies, the Commissioner shall determine the Normal Tax liability of the taxpayer as well as the other party to the transaction as if that cession had not been effected. In other words, where a person cedes his right to receive income in exchange for a right to receive a dividend, which would be exempt had section 103(5) of the IT Act not applied, the Normal Tax liability of the cedent and cessionary will be determined as if that cession had never taken place. The anti-avoidance would therefore override the tax implications discussed in this chapter; it would only be applicable in specific transactions identified by the Commissioner. For general transactions, not within the scope of the anti-avoidance transactions, the findings of the Normal Tax and Dividends Tax implications are submitted in **Table 7.1** below.

Table 7.1: Summary of Normal Tax and Dividends Tax implications of the receipt of dividend ceded

Person	Cession *before* dividend accrued	Cession *after* dividend accrued
Cedent	**Normal Tax implications** Any amount received will not be received for the own benefit of the cedent and will not form part of its gross income and no Normal Tax implications will arise.	**Normal Tax implications** Any amount received will not be received for the own benefit of the cedent and will not form part of its gross income and no Normal Tax implications will arise.
	Dividends Tax implications The deemed beneficial owner rules contained in section 64EB will not apply and the cedent will not be the beneficial owner and no Dividends Tax implications will arise.	**Dividends Tax implications** Where the cessionary is an entity which is exempt in terms of section 64F of the IT Act, the deemed beneficial owner rules contained in section 64EB of the IT Act will apply and the Dividends Tax liability, with regard to the entity type of the cedent, will fall on the cedent.
Cessionary	**Normal Tax implications** Any amount received will be included in the gross income of the cessionary but will generally be exempt from Normal Tax under section 10(1)(k) of the IT Act. However, where the cessionary is a company which does not acquire the entire share as a result of the cession, section 10(10(k)(i)(*ee*) applies and the amount will not be exempt.	**Normal Tax implications** Any amount received will be included in the gross income of the cessionary but will generally be exempt from Normal Tax under section 10(1)(k) of the IT Act. However, where the cessionary is a company which does not acquire the entire share as a result of the cession, section 10(10(k)(i)(*ee*) applies and the amount will not be exempt.
	Dividends Tax implications The cessionary will be the beneficial owner of the dividend and will be subject to Dividends Tax, unless it is an entity which is exempt in terms of section 64F of the IT Act.	**Dividends Tax implications:** Unless the deemed beneficial owner rules contained in section 64EB of the IT Act apply, the cessionary will be the beneficial owner of the dividend and will be subject to Dividends Tax, unless it is an entity which is exempt in terms of section 64F of the IT Act.

Source: Author's compilation

CHAPTER 8

CONCLUSION

8.1. General

The findings of this research suggest, in agreement with Morphet (2011:3), that the advent of Dividends Tax has further complicated the cession of a right to income. Further uncertainty has been created by the numerous amendments and a lack of definitive guidance from SARS. Taxpayers who enter into agreements whereby the right to receive a dividend is ceded currently do not have any guidance on the tax implications of such a transaction, other than the implications for Dividends Tax purposes. The aim of this research was to provide a summary of the overall tax implications of a cession of the right to receive a dividend which could serve as guidance which is currently lacking. Such a summary could serve as the basis for tax planning procedures for shareholders and companies wishing to acquire a stream of dividend income. This research could further assist SARS in drafting definitive guidance on the overall tax implications of the cession of the right to receive a dividend, as well as the legislature to enact amendments or provide clarity where uncertainties remain. The objective of this research was to investigate the tax implications of a cession of the right to receive a dividend for the cedent, the cessionary and the declaring company involved in the cession of a dividend.

As starting point the nature of a share and the type of right being ceded (as a real right or a personal right) was investigated as the tax treatment in respect of different rights would differ. The rights attached to a share are submitted as a complex bundle of personal rights, but can also be seen as subject to a usufruct and regarded as a quasi-usufruct. The rights created as a result of a cession of the right to receive a dividend, when considered in light of the different theories and tests applied in distinguishing between real and personal rights (summarised in **Table 2.2**), could either be a real right or a personal right. The nature of the right between the cessionary and the cedent would depend on the circumstances of each case although in principle it is submitted as a personal right. Concluding on whether the right constitutes a personal right or real right is especially relevant when determining whether the rights created as a result of cession of the right to receive a dividend could constitute a usufruct. A usufruct can be defined as a right which confers on the usufructuary the right to the use and the enjoyment of an object, owned by another person, in a manner which preserves its substance. Where relevant, the tax implications have also been discussed for a real and personal right separately in the other chapters.

Based on an investigation of the STT implications of the cession of the right to receive a dividend, the amendment to the STT Act on 1 April 2012, corresponding with the introduction of Dividends Tax, is of key importance as can be seen from the summary in **Table 3.1**:

- Prior to 1 April 2012, a security, for purposes of STT, included the right or entitlement to receive a distribution from a company. The cession of the right to receive a dividend was therefore subject to STT.
- From 1 April 2012 the right or entitlement to receive a distribution from a company no longer constitutes a security and a cession of the right to receive a dividend no longer results in an STT liability.

The VAT implications of the cession of the right to receive a dividend were also investigated in the study. As a starting point, the VAT implications of the transfer of the ownership of equity shares and the declaration of a dividend (both a dividend *in specie* and a dividend other than a dividend *in specie*) were investigated. The conclusion reached was that neither the transfer of ownership of equity shares nor the declaration of a cash dividend would result in a liability for output tax. The cession of the right to receive a dividend would not constitute an equity share as defined and would not qualify as either the transfer of ownership of equity share or the declaration of a dividend and, unlike the transfer of ownership of equity shares or the declaration of a cash dividend, would result in an output tax liability as not an exempt financial service. Furthermore, the cessionary would not qualify for an input tax deduction unless the right to receive a dividend is used in the course and furtherance of an enterprise. The position of the declaring company was considered and the conclusion reached was that only in the case of a dividend *in specie*, where the asset distributed was used in the course and furtherance of an enterprise, would the declaring company have to account for output tax.

Possible Donations Tax implications were also investigated based on the fact that the consideration paid by the cessionary may not be adequate. Where a donation or deemed donation takes place the Donations Tax implications will differ depending on whether the right to receive a dividend constitutes a personal right or a real right. In the case of a personal right, the value upon which Donations Tax must be calculated will be the price which could have been obtained between a willing buyer and a willing seller dealing at arm's length in the open market. In the case of a real right, such as a usufruct or like interest, the value will be an amount capitalising at 12% of the annual value of the right of enjoyment over which the interest is held, over the expectation of life of the donor, or if the right is to be held for a shorter period, over that period. The conclusion was reached that, in the case of a donation or deemed donation, a Donations Tax liability would arise for the cedent, the value of which would depend on the nature of the right to receive a dividend.

The Normal Tax (including Capital Gains Tax) implications of a cession of the right to receive a dividend were considered for both the cedent and the cessionary. A distinction was drawn between the right to receive a dividend as revenue or capital in nature, with a further distinction between personal rights and real rights as illustrated in **Table 6.1**. The findings indicated that a cedent who receives an amount of a revenue nature must include the amount in its gross income, with an allowable deduction for a portion of the cost of acquisition of the share. Where the cedent receives an amount that is capital in nature, the right constitutes an asset for purposes of Capital Gains Tax and in the case of a real right the findings suggests that the right could constitute a usufruct. As a part disposal, the distinction between a personal right and a usufruct is important as this determines how the market value and base cost of the disposal must be calculated. With regard to the cessionary, where the right is acquired as revenue in nature, expenditure incurred to acquire that right would generally not be deductible, as the income received from that right would generally constitute exempt dividends. In the case where the right to receive a dividend was acquired by the cessionary with a capital intention the expenditure incurred by the cessionary would represent the base cost of the asset. Upon expiry of the right it was found that a capital loss will be realised by the cessionary, which capital loss will be disregarded where the right to receive a dividend was a real right in the form of a usufruct.

As a final point of investigation the Normal Tax and Dividends Tax implications for the cedent and cessionary were considered on the subsequent receipt of the dividend. It is considered to be of key importance to establish whether the cession of the right to receive a dividend occurred prior to the declaration of a dividend or thereafter:

- Where the cession occurred **prior to the declaration** of a dividend the amount will be included in the gross income of the cessionary, irrespective of whether or not the amount is physically received by the cedent as a registered shareholder. Such an amount would generally be exempt from Normal Tax but would be subject to Dividends Tax unless the cessionary is an exempt entity. However, where the cessionary is a company that does not acquire the entire share as a result of the cession, the amount will not be exempt from Normal Tax.
- Where the cession occurred **after the declaration** of a dividend the Normal Tax implications for the cedent and cessionary would mirror those of a cession prior to the declaration of a dividend. The Dividends Tax implications would, however, differ from the position where the cession took place prior to the declaration as the deemed beneficial owner provisions could apply and the cedent could be deemed to be the beneficial owner of the dividend. In such a case the cedent will be subject to Dividends Tax unless the cedent is an exempt entity.

The conclusion was drawn that, where the cession occurred after the declaration, a situation could exist where the deemed beneficial ownership rules would apply and the cedent will be liable for Dividends Tax, while the cessionary could be a resident company who will receive a dividend which will not be exempt from Normal Tax. It is therefore conceivable that the receipt of a dividend as a result of the cession of the right to receive a dividend could be subject to tax in the hands of both the cedent and the cessionary.

The findings of the investigation of the tax implications of a cession of the right to receive a dividend are submitted in **Table 8.1** which follows the recommendations and concluding remarks of this study.

8.2. Recommendations and concluding remarks

The starting point for determining the tax implications of a cession of the right to receive a dividend would be to determine the type of right being ceded (as a real or a personal right).

Once the nature of the right being ceded has been determined, the tax implications for all types of tax must be determined. During the investigation of the VAT implications of the cession of a right to receive a dividend, the definition of an ‘equity share’, in section 2 of the VAT Act, was considered and the conclusion was reached that the definition does not include the right to receive a dividend. Accordingly, the inclusion of the transfer of ownership of an equity share as exempt from VAT, as financial services, will not be applicable to the transfer of the right to receive a dividend. It is recommended that, if the intention of the legislature was to exclude of the right to receive a dividend from the definition of an equity share, the definition should be amended to specifically exclude the right to receive a dividend for the avoidance of doubt. However, if the contrary is the case, in other words if the legislature did not intend for the right to receive a dividend to not qualify as financial services, the definition of equity share should be broadened to include such an exemption.

A further recommendation is that the lack of definitive guidance from SARS regarding the tax implications of a cession of the right to receive a dividend should be addressed. Definitive guidance from SARS could assist taxpayers in determining the type of right being ceded, which would enable them to determine the tax implications that follow. Furthermore, such definitive guidance could act as a deterrent for avoidance schemes, as taxpayers would be well informed of the effects of the numerous amendments made. This guide could contain a table such as **Table 8.1** which follows.

Table 8.1: Summary of the tax implications of a cession of the right to receive a dividend

Tax type	Cedent	Cessionary	Declaring company
Securities Transfer Tax			
Cession **prior to** 1 April 2012	None	Subject to STT	Where the share was unlisted, the STT liability was on the company, with a right to be refunded by the cessionary.
Cession **after** 1 April 2012	None	None	None
Value-Added Tax			
Cession of the right to receive the dividend	Cession by a vendor of the right to receive a dividend, where that cession is in the course and furtherance of an enterprise, will be a supply of services subject to VAT.	Where the right to receive a dividend is acquired to subsequently receive a dividend, no input tax deduction will be allowed.	The cession does not have VAT consequences for the company.
Declaration of a dividend	None	No input tax deduction will be allowed where the cessionary receives either a cash dividend or dividend *in specie.*	The declaration of an asset used in the course and furtherance of an enterprise as a dividend *in specie* results in a taxable supply.

Tax type	Cedent	Cessionary	Declaring company
Donations Tax			
Right to receive a dividend as **personal right**	Value of the donation will be the price which could be obtained between a willing buyer and willing seller dealing at arm's length in the open market.	None	None
Right to receive a dividend as a **real right**	The value will be determined as an amount determined by capitalising at 12% the annual value of the right of enjoyment of the property over which such interest was or is held, over the expectation of life of the donor, or if the right is to be held for a lesser period, that period.	None	None
Normal Tax on the cession of dividend			
Receipt or accrual of **revenue** nature	Consideration received from cessionary to be included in gross income and not exempt from Normal Tax. It will therefore constitute income. A deduction of a portion of the acquisition cost of the share may be possible.	Consideration paid to cedent (expenditure incurred) to acquire the right to receive a dividend will not be deductible, unless the right is on-sold or the eventual receipt of the dividend is not exempt income.	None

Tax type	Cedent	Cessionary	Declaring company
Receipt or accrual of **capital** nature	The disposal of the right to receive a dividend as a **personal right** will be a part disposal calculated on the basis that the market value is the price which could have been obtained between a willing buyer and a willing seller who are dealing at arm's length in the open market.	The expenditure actually incurred to acquire the right to receive a dividend as a **personal right** will constitute the base cost of that asset. Upon the expiry of the right the cessionary will realise a capital loss.	None
	The disposal of the right to receive a dividend as a **real right in the form of a usufruct** will be a part disposal calculated on the basis that the market value is an amount determined by capitalising, at 12%, the market value of the full ownership of the asset over the expected life of the person who acquires that right, or if the right is to be held for a lesser period, over that period.	Where the right to receive a dividend constitutes a **real right in the form of a usufruct**, the expenditure actually incurred would constitute the base cost of the asset. Upon expiry of the right, a capital loss will be incurred, which loss will be disregarded.	None

Tax type	Cedent	Cessionary	Declaring company
Normal Tax and Dividends Tax on subsequent receipt of the dividend			
Cession **before** dividend accrued	**Normal Tax:** None The amount received will not be received for own benefit and will not from part of gross income.	**Normal Tax:** The dividend received is included in gross income but generally exempt. If the cessionary is a company and does not acquire the entire share, the amount will not be exempt.	None
	Dividends Tax: None The deemed beneficial owner rules will not apply.	**Dividends Tax:** The cessionary will be the beneficial owner and subject to Dividends Tax unless the cessionary is exempt from Dividends Tax.	
Cession **after** dividend accrued	**Normal Tax:** None The amount received will not be received for own benefit and will not from part of gross income.	**Normal Tax:** The dividend received is included in gross income but generally exempt. If the cessionary is a company and does not acquire the entire share, the amount will not be exempt.	None
	Dividends Tax: Where the cessionary is exempt from Dividends Tax, the deemed beneficial owner rules will apply and the Dividends Tax liability, if any, will fall on the cedent.	**Dividends Tax:** Unless the deemed beneficial rules apply, the Dividends Tax liability will be on the cessionary. Unless the cessionary is exempt from Dividends Tax, it will be liable for Dividends Tax.	None

Source: Author’s compilation

LIST OF REFERENCES

Badenhorst, P.J., Pienaar, J.M. and Mostert, H. 2015*. Silberberg and Schoeman's The Law of Property.* 5th edition. [Online] Available from: http://www.mylexisnexis.co.za/. [Accessed: 2016-02-28].

Cape Explosive Works Ltd and Another v Denel (Pty) Ltd and others 2001 3 SA 569 (SCA). (19 March 2001).

Clegg, D. and Stretch, R. 2015*. Income Tax in South Africa.* [Online] Available from: http://www.mylexisnexis.co.za. [Accessed: 2015-09-20].

CIR v Cactus Investments (Pty) Ltd [1996] 60 SATC 141. (17 April and 5 July 1996).

Commissioner for South African Revenue Service v Mobile Telephone Networks Holdings (Pty) Ltd [2014] ZASCA 4. (7 March 2014).

Commissioner for South African Revenue Service v British Airways Plc [2005] ZASCA 20. (8 June 2005).

Cooper v Boyes NO and Another 1994 (4) SA 521 (C). (25 August 1994).

Croome, B.J., Oguttu, A.W., Muller, E., Legwaila, T., Kolitz, M., Williams, R.C. and Louw, C. 2013*. Tax Law: An introduction.* 1st edition. [Online] Available from: https://books.google.co.za. [Accessed: 2016-07-08].

De Koker, A.P. and Williams, R.C. 2016a. Chapter 9 'Dividends Tax' in *Silke on South African Income Tax*. [Online] Available from: http://www.mylexisnexis.co.za5. [Accessed: 2016-06-17].

De Koker, A.P. and Williams, R.C. 2016b. Chapter 23 'Donations Tax, paragraph 23.5, Deemed Donations' in *Silke on South African Income Tax*. [Online] Available from: http://www.mylexisnexis.co.za. [Accessed: 2016-06-17].

De Koker, A.P. and Williams, R.C. 2016c. Chapter 23 ‘Donations Tax, paragraph 23.6, Exemptions’ in *Silke on South African Income Tax*. [Online] Available from: http://www.mylexisnexis.co.za. [Accessed: 2016-06-16].

De Waal, M.J., Erasmus, H.J., Gauntlett, J.J. and Wiechers, N.J . Volume 31 – Second Edition Volume*. Law of South Africa. Wills and Succession, Administration of Deceased Estates and Trusts. Usufruct, Usus and Habitatio.* [Online] Available from: http://www.mylexisnexis.co.za. [Accessed: 2016-04-17].

Ex Parte Geldenhuys OPD 155. (15 April 1926 and 20 May 1926).

Ex Parte Estate Paley 1943 CPD 181. (10 February 1943 and 26 February 1943).

Geldenhuys v CIR 14 SATC 419 1947(3) SA 256 (C).

Hiddingh v CIR 11 SATC 205 1940 AD. (29 November 1940).

ITC 554 (1944) 13 SATC 211 (U). (2 February 1944).

ITC 1378 (1983) 45 SATC 230 (T). (11 April 1983).

ITC 1599 (1995) 58 SATC 88 (T). (31 July and 11 August 2995).

Johnson, E. 2016. Formulation of guidance on the South African income tax consequences of expenditure incurred in a tender process. Unpublished Master’s thesis. Stellenbosch: Stellenbosch University.

Joubert, W.A. 2012*. Law of South Africa. Companies: Part 1. Shares and Share Capital, The Conceptual Basis.* [Online] Available from: http://www.mylexisnexis.co.za. [Accessed: 2016-04-17].

KPMG. SAICA Integritax April 1997. *VAT implications of dividends, including dividends in specie.* [Online] Available from: https://www.saica.co.za/integritax/1997/413_VAT_implications_of_dividends_including_dividends_in_specie.htm. [Accessed: 2015-10-10].

Leos, E. 2006. Quasi-Usufruct and Shares: Some Possible Approaches. *South African Law Journal*, 123(1):126–146.

Lynn & Main Inc v Brits Community Sandworks CC [2008] JOL 22418 (SCA). (17 September 2008).

Morphet, A. 2011. Dividend Cessions. *DLA Cliffe Dekker Hofmeyer Tax Alert, 10 June 2011.*

National Treasury. 2012. *Urgent Joint Media Statement: Proposed addition to 2012 Tax Laws Amendment Bills to close Tax avoidance schemes related to the Dividends Tax*. [Online]. Available from http://www.treasury.gov.za/comm_media/press/2012/2012083102.pdf [Accessed: 2015-08-10].

Oxforddictionaries.com. N.d. U.w. *Oxford Dictionaries Language Matters.* [Online]. Available from http://www.oxforddictionaries.com/definition [Accessed: 2016-06-16].

SARS. 2007. *Explanatory memorandum on the securities transfer tax bill, 2007.* Pretoria: South African Revenue Service.

SARS. 2008. *Explanatory memorandum on the revenue laws amendment bill, 2008.* Pretoria: South African Revenue Service.

SARS. 2010. *Binding Private Ruling 089:Waiver of certain rights connected to shares*. 12 July 2010. Pretoria: South African Revenue Service.

SARS. 2011. *Explanatory memorandum on the taxation laws amendment bill, 2011*. 27 January 2012. Pretoria: South African Revenue Service.

SARS. 2012. *Explanatory memorandum on the taxation laws amendment bill, 2012*. 10 December 2012. Pretoria: South African Revenue Service.

SARS. 2013a. *A Quick Guide to Dividends Tax*. April 2013. Pretoria: South African Revenue Service.

SARS. 2013b. *Explanatory memorandum on the taxation laws amendment bill, 2013*. 24 October 2013. Pretoria: South African Revenue Service.

SARS. 2014. *Tax Guide for Share Owners (Issue 4), 2014*. 17 February 2014. Pretoria: South African Revenue Service.

SARS. 2015a. *Comprehensive Guide to Capital Gains Tax (Issue 5), 2015*. 9 December 2015. Pretoria: South African Revenue Service.

SARS. 2015b. *Comprehensive Guide to Dividends Tax*. 23 February 2015. Pretoria: South African Revenue Service.

SARS. 2015c. *VAT 404 Guide for Vendors, 2015*. 31 March 2015. Pretoria: South African Revenue Service.

Schreuder v Steenkamp [1962] 3 All SA 475 (O). (7 June 1962).

Silver, M. & Beneke, C. 2015. 10th edition. *Deloitte VAT Handbook.* [Online] Available: from: http://www.mylexisnexis.co.za [Accessed: 2015-10-11].

South Africa. 1962. *Income Tax Act, No. 58 of 1962 (as amended)*. Pretoria: Government Printer.

South Africa. 1973. *Companies Act, No. 61 of 1973 (as amended)*. Pretoria: Government Printer.

South Africa. 1991. *Value-Added Tax Act, No. 89 of 1991 (as amended)*. Pretoria: Government Printer.

South Africa. 2007. *Securities Transfer Tax Act, No 25 of 2007 (as amended)*. Pretoria: Government Printer.

South Africa. 2008. *Companies Act, No. 61 of 2008 (as amended)*. Pretoria: Government Printer.

South Africa. 2011a. *Tax Administration Act, No. 28 of 2011 (as amended)*. Pretoria: Government Printer.

South Africa. 2011b. *Taxation Laws Amendment Act, No. 24 of 2011.* Pretoria: Government Printer.

South Africa. 2012. *Taxation Laws Amendment Act, No. 22 of 2012.* Pretoria: Government Printer.

South Africa. 2013. *Taxation Laws Amendment Act, No. 31 of 2013.* Pretoria: Government Printer.

Standard Bank of South Africa Ltd and Another v Ocean Commodities Inc and Others [1983] 1 All SA 145 (A). (29 September 1982).

Swart, G. 2005. Interpreting Some Core Concepts Governing the Taxation of Capital Gains. *SA Mercantile Law Journal*, 17(1):1–18.

TCT Leisure (Pty) Ltd v Commissioner for the South African Revenue Services [2010] 3 All SA 325 (SCA). (12 March 2010).

Van der Merwe, B.A. 1998. Cession of a Right to Future Income – Income Tax Implications. *SA Mercantile Law Journal*, 10:354–367.

Van der Merwe, C.G. 2015*. Law of South Africa. Things. Theoretical Distinction between real and personal rights.* [Online] Available from: http://www.mylexisnexis.co.za [Accessed: 2016-04-17].

Van der Walt, A.J. & Maass, S. 2012. The enforceability of tenants' rights (part 1). *South African Law Journal*, Issue 1:35–52.

Viviers, H. 2015. *Considering the VAT effects of dividends*. TaxTalk July/August 2015. [Online] Available from: http://www.taxtalk.co.za/considering-the-vat-effect-of-dividends. [Accessed: 2015-10-10].

Welch v CSARS [2004] 2 All SA 586 (SCA). (21 May 2004).